Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1051 (Delegate Walker)
Ways and Means

Enterprise Zone and Regional Institution Strategic Enterprise Zone Programs - Small Business Entities

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This bill expands the enterprise zone and Regional Institution Strategic Enterprise (RISE) zone programs by creating an additional income tax credit for qualified small businesses located within the zones. The credit may be claimed over five tax years and in each year is equal to a specified percentage of the wages that are withheld from qualified employees. The bill also specifies that qualified property for purposes of the RISE zone property tax credit includes personal property located in a focus area.

The property tax credit provisions take effect June 1, 2017, and apply to all taxable years beginning after June 30, 2017. The income tax credit provisions take effect July 1, 2017, and apply to tax year 2017 and beyond.

Fiscal Summary

State Effect: General fund revenues decrease beginning in FY 2018 due to credits claimed against the personal and corporate income tax. Transportation Trust Fund (TTF) and Higher Education Investment Fund (HEIF) revenues decrease beginning in FY 2018 due to credits claimed against the corporate income tax. Expenditures are not affected.

Local Effect: Local highway user revenues decrease as a result of any credits claimed against the corporate income tax. Property tax revenues in counties and municipalities in which a RISE zone is designated may decrease due to additional property tax credits. Local expenditures are not affected.

Small Business Effect: Potential meaningful. Small businesses that claim the credit will benefit from reduced tax liabilities.

Analysis

Bill Summary: A small business entity is a business or nonprofit organization with 25 or fewer employees. The business may qualify for the tax credit (1) regardless of whether the business was located within an enterprise zone or RISE zone before the zone designation and (2) if, after the zone designation, the business hired and retained at least 1 new employee for at least six months before or during the tax year in which the business claims the credit. A small business entity does not include a person who owns, operates, develops, constructs, or rehabilitates property if the real property is intended for use primarily as single or multifamily residential property located within the zone.

The income tax credit is a five-year credit based on a portion of the amount of tax that the business is required to withhold for the taxable year from the wages of qualified employees. A qualified employee is a person who works in the zone and whose earnings exceed the State median income for the preceding tax year. In the first year, the credit is equal to 5% multiplied by the amount of withholdings that are remitted to the Comptroller on behalf of the eligible employee. In successive credit years, the percentage of wages eligible for the credit decreases by 1% in each year and equals 1% in the fifth and final credit year. The amount of the credit may not exceed the tax liability imposed in the year. Any unused amount of the credit can be carried forward to future tax years until the full amount of the excess is used.

Current Law:

Tax Credit Eligibility – Regional Institution Strategic Enterprise Zones

Tax credits may be awarded to a business entity that (1) moves into or locates in a RISE zone on or after the date that the zone is designated or (2) is located within the zone prior to designation if the business entity makes a significant capital investment or expansion of its labor force after a RISE zone is designated. Regulations adopted by the Department of Commerce (Commerce) require each zone to have criteria that determine the minimum capital investment and labor force increase that a business must undertake to qualify for tax credits. A business may not qualify for tax credits unless Commerce, in consultation with the county or municipal corporation in which the zone is located, certifies that the business and its location is consistent with the target strategy of the zone.

A local government must grant a property tax credit against local real property taxes imposed on the eligible assessment of qualified property owned by a business entity. A business entity is a person who operates or conducts a trade or business, and it includes a person who operates, develops, constructs, or rehabilitates real property if the real property is intended for use primarily as single or multifamily residential property and is partially devoted to a nonresidential use. Qualified property is real property that is not used for residential purposes, used in a trade or business by a business entity, and located in a RISE zone. State property taxes imposed on real property are not affected.

Regional Institution Strategic Enterprise Zones Property – Tax Credits

The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property improvements, which is calculated by the State Department of Assessments and Taxation (SDAT). Enhanced credits are granted if the property is located within a State enterprise zone or focus area within an enterprise zone.

As shown in **Exhibit 1**, the credit is applied to the tax imposed on 50% of the eligible assessment during the first year, and 10% in the second through fifth year. For qualified property within an enterprise zone, a business can receive an 80% credit for the five-year period, and for qualified property within a focus area of an enterprise zone, a business can receive a 100% credit for the five-year period.

If the RISE zone in which the business is located is renewed by Commerce, a business may claim an additional property tax credit equal to 10% of the eligible assessment in years 6 through 10. The governing body of a county or municipal corporation may increase by local law the value of the credit shown in Exhibit 1.

Exhibit 1
RISE Zone Property Tax Credit
Percentage of Eligible Property Assessment

Taxable Year	Percentage
1	50%
2-5	10%
6-10*	10%

RISE: Regional Institution Strategic Enterprise

*Business may receive a credit of 10% in years 6-10, but only if the zone is redesignated by the Department of Commerce.

Source: Department of Legislative Services

Tax Credit Eligibility – Enterprise Zones

Businesses located in an enterprise zone must be certified by the local enterprise zone administrator in order to be eligible to receive the income tax credit (including the focus area credit). To qualify for the credit, businesses must hire at least one employee who (1) is hired after the business was located in the enterprise zone or after the enterprise zone was designated; (2) is employed by the business for at least 35 hours per week for 6 months (or 12 months in a focus area) before or during the taxable year in which the credit is taken; (3) spends at least 50% of the workday either in the enterprise zone or on an activity related to the enterprise zone; (4) is hired to fill a new position (*i.e.*, the firm's number of new full-time positions must increase by the number of credits taken); and (5) earns at least 150% of the federal minimum wage. Businesses claiming the credit for hiring an economically disadvantaged employee must obtain certification from the Department of Labor, Licensing, and Regulation. Once certified, a business may claim the income tax credit.

In addition to the State standards that a business entity must meet to participate in the enterprise zone program, each political subdivision is authorized to establish additional local standards to govern access to the program. Each zone has a local administrator who determines if a business entity meets the required local standards. These additional local standards generally require a minimum capital investment or a minimum number of jobs created, or both. A few enterprise zones have additional standards limiting the type or category of business entity that is eligible to participate.

Income Tax Incentives – Enterprise Zones and Regional Institution Strategic Enterprise Zones

A qualified business entity within an enterprise and RISE zone may claim enterprise zone income tax credits. There are two types of income tax credits: a general income tax credit and an enhanced income tax credit for hiring economically disadvantaged employees. As shown in **Exhibit 2,** the general income tax credit is a one-time $1,000 credit per new employee filling a newly created position, or $1,500 for each qualified new employee in a focus area. For economically disadvantaged employees, the credit increases to a total of $6,000 per new employee, or $9,000 per new employee in a focus area. The tax credit for economically disadvantaged employees is claimed over a three-year period.

Exhibit 2
Enterprise Zone and RISE Zone
Income Tax Credit

Enterprise/RISE Zone	
Regular employee	$1,000 per employee (one time)
Economically disadvantaged employee	$6,000 per employee (over three years)
Focus Area	
Regular employee	$1,500 per employee (one time)
Economically disadvantaged employee	$9,000 per employee (over three years)

RISE: Regional Institution Strategic Enterprise
Source: Department of Legislative Services

Background:

Regional Institution Strategic Enterprise Zones

Chapter 530 of 2014 established the RISE zone program, which is administered by Commerce. RISE zones must be located in the immediate proximity of a private or public four-year institution or community college. Two RISE zones have been approved to date – one which is located directly adjacent to the University of Maryland, Baltimore, in the university's BioPark and the second which is in and around the campus of the University of Maryland, College Park.

Enterprise Zones

The Enterprise Zone Tax Credit Program, established in 1982, is intended to encourage economic growth within economically distressed areas of the State and to increase employment of the chronically unemployed. The Secretary of Commerce may only designate an area as an enterprise zone if it is in a priority funding area and satisfies at least one criterion related to economic distress.

The State reimburses local governments for one-half of the cost of the enterprise zone property tax credit. From fiscal 2001 to 2014, State reimbursements to local governments totaled $131.2 million. In fiscal 2014, about 850 properties earned a total of $27.8 million in property tax credits, of which the State reimbursed $13.9 million. Since tax year 2000, an annual average of $900,000 in enterprise zone income tax credits have been claimed. About one-third of all enterprise zones have businesses that are concentrated within manufacturing, fabrication, transportation, warehousing, distribution, and research and development. This concentration typically results from either enterprise zone local standards restricting credit eligibility to these activities and industries or the establishment of the zone within an industrial or business park that has similar requirements.

Pursuant to the Tax Credit Evaluation Act, the Department of Legislative Services (DLS) evaluated the enterprise zone tax credit and made several recommendations in a report issued in August 2014. DLS concluded that enterprise zone tax credits are not effective in creating employment opportunities for nearby residents and that Commerce, SDAT, and local governments do not have a framework or metrics in place for measuring the effectiveness of the credit.

The DLS evaluation of the enterprise zone tax credit can be found here.

State Revenues: Tax credits may be claimed beginning in tax year 2017. As a result, general fund, TTF, and HEIF revenues may decrease beginning in fiscal 2018. There are currently 31 enterprise zones and 2 RISE zones. According to the Comptroller's Office, there are about 82,000 businesses that have 25 or fewer employees in the State. Based on the median wage and amount of wages withheld by these businesses, the Comptroller's Office estimates that each qualifying business could claim a tax credit of $574 in the first year and $115 in the fifth and final tax year. Accordingly, State revenue losses resulting from the bill will likely be significant.

Additional Information

Prior Introductions: None.

Cross File: SB 1021 (Senator Zucker, *et al.*) - Budget and Taxation.

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

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