

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 378 (The Speaker, *et al.*) (By Request - Administration)
 Ways and Means

Cybersecurity Investment Incentive Tax Credit - Eligibility and Sunset Extension

This Administration bill extends through fiscal 2023 the termination date of the cybersecurity investment incentive tax credit. The bill also alters the program by specifying that the investor who makes the qualifying investment in a Maryland cybersecurity company claims the tax credit instead of the cybersecurity company.

The bill takes effect June 1, 2017, and applies to tax credit certificates issued after June 30, 2017.

Fiscal Summary

State Effect: General fund expenditures increase by \$2.0 million annually in FY 2020 through 2023 due to mandated appropriations to the program. Revenues are not materially affected. **This bill extends a mandated appropriation beginning in FY 2020.**

(\$ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	0	2.0	2.0	2.0
Net Effect	\$0.0	\$0.0	(\$2.0)	(\$2.0)	(\$2.0)

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

Local Effect: Local highway user revenues decrease as a result of any credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services concurs with this assessment as discussed below.

Analysis

Current Law: Chapter 390 of 2013 established a refundable tax credit for investments in qualified cybersecurity companies. The Department of Commerce administers the tax credit application, approval, and certification process and is required to submit a report to the Governor and the General Assembly detailing specified information about the tax credit each year.

A qualified Maryland cybersecurity company can claim a credit equal to 33% of a qualified investment, not to exceed \$250,000. Chapter 504 of 2016 increased the value of the tax credit if the qualified cybersecurity company in which an investment is made is located in Allegany, Dorchester, Garrett, or Somerset counties. The value of the credit for investments made in these companies is equal to 50% of the investment, not to exceed \$500,000.

A qualifying company is a for-profit entity that is primarily engaged in the development of innovative and proprietary cybersecurity technology and meets specified criteria including requirements that the company (1) has been in business for no more than five years; (2) has less than 50 full-time employees; (3) has its headquarters and base of operations in Maryland; (4) is not publicly traded on any exchange; (5) has not participated in the tax credit program for more than one prior fiscal year; (6) owns or has properly licensed any proprietary technology; and (7) has an aggregate capitalization of at least \$100,000.

A qualified investment is an at-risk investment of at least \$25,000 in exchange for stock or ownership interest. Generally, the total amount of tax credits issued in the fiscal year cannot exceed the amount appropriated to the Cybersecurity Investment Tax Credit Reserve Fund in that year. The Department of Commerce may not certify investments in a single cybersecurity company that total more than 15% of the total appropriations to the reserve fund for that fiscal year. Tax credit applications are approved on a first-come, first-served basis until the total cap for the year is reached. The Governor is required to appropriate at least \$2 million to the reserve fund in each fiscal year.

Background: As shown in **Exhibit 1**, the Department of Commerce has certified a total of \$2.7 million in final tax credits to 10 companies. Most of these companies are located in Baltimore City and Montgomery County.

Exhibit 1
Cybersecurity Investment Incentive Tax Credits
Fiscal 2014-2017

<u>Fiscal Year</u>	<u>Companies</u>	<u>Final Credits</u>
2014	3	\$996,050
2015	2	575,425
2016	3	900,425
2017	2	268,890
Total	10	\$2,740,790

Note: Fiscal 2017 reflects final credits issued as of December 31, 2016.

Source: Department of Commerce

The Montgomery County cybersecurity tax credit supplement program provides additional funds to cybersecurity companies that receive a State tax credit and have their headquarters and base of operations in Montgomery County. The credit is equal to 50% of the State credit received, not to exceed 15% of the amount appropriated to the Montgomery County program. Montgomery County provided \$483,000 to the program for fiscal 2017 and has awarded funds to two companies as of February 2017.

State Expenditures: The bill extends the termination date of the program to June 30, 2023, and continues the requirement that the Governor appropriate at least \$2.0 million to the reserve fund in each year. Assuming the program is funded at this level, general fund expenditures will increase by \$2.0 million annually in fiscal 2020 through 2023. However, there is no limit on the amount that can be appropriated to the reserve fund. To the extent that the Governor provides more money to the reserve fund in any year, the increase in general fund expenditures will be greater.

Small Business Effect: The tax credit program requires a qualified cybersecurity company to have less than 50 full-time employees. Accordingly, the proposed extension and changes to the program allowing an investor to claim the credit will positively impact small businesses that receive investments under the program; however, it is expected that a limited number of businesses will benefit.

Additional Information

Prior Introductions: None.

Cross File: SB 318 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

Information Source(s): Department of Commerce; Montgomery County; Department of Legislative Services

Fiscal Note History: First Reader - February 20, 2017
md/jrb

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Department of Commerce - Cybersecurity Investment Incentive Tax Credit Program

BILL NUMBER: SB 318/HB 378

PREPARED BY: Nancy McCrea, Research Director (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

WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND
SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

Maryland's Cybersecurity Investment Incentive Tax Credit (CIITC) program provides a refundable income tax credit to Qualified Maryland Cybersecurity Companies (QMCCs) that secure investment from investors. The purpose of this new program is to incentivize and attract cybersecurity companies to startup in or move to Maryland; and to attract investment to cybersecurity companies in order to help them grow, create jobs and retain intellectual property in Maryland.

Unlike the Biotech Investor Tax Credit, the CIITC benefit goes to the company rather than the investor. Because there is no incentive for investors to participate demand for the tax credit has been low. Demand for the tax credit peaked in calendar 2015 at just over \$1 million. Most fiscal years have activity of about \$1 million. To date, less than one-fourth of appropriated funds have been awarded. Just nine qualified cyber companies have benefitted from the credit and raised nearly \$12 million in investment.

MARYLAND CYBERSECURITY INVESTMENT INCENTIVE TAX CREDIT PROGRAM
ACTIVITY SUMMARY

FISCAL YEAR	FY APPROPRIATION	MANDATORY RECOVERY	REMAINING APPROPRIATION	\$ CAPITAL RAISED	\$ FINAL TAX CREDITS	\$ CARRY FORWARD	# QMBC1 ASSISTED	# APPROVED INVESTOR APPLICATIONS
2014 (1)	\$3,000,000	\$1,000,000	\$2,000,000	\$3,771,259	\$1,003,950	\$996,050	3	15
2015 (2)	\$4,000,000	\$3,800,000	\$200,000	\$3,632,498	\$620,625	\$575,425	2	5
2016 (3)	\$1,500,000	\$500,000	\$1,000,000	\$4,562,501	\$675,000	\$900,425	3	19
2017 (4)	\$2,000,000	\$2,000,000	\$0	Pending	Pending	Pending	1	2
	\$10,500,000	\$7,300,000	\$3,200,000	\$11,966,258	\$2,299,575		9	41

The CIITC program is designed to assist early stage, startup businesses and all of the recipients to date have been small businesses. The average size of the QMCCs is 23 employees.

This legislation would change the program to mirror the Biotech Investor Tax Credit and provide the tax credits to qualified investors. It is expected that this change would provide more incentive for investors to invest in QMCC's and thereby encourage the intellectual property and base of operations of the QMCC to remain in Maryland. With increased demand for the funds the program would be able to assist more of these small cyber companies. Had the program been fully subscribed since inception it could have assisted more than 30 companies to potentially raise over \$50 million.