SB 663

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 663 (Senator Edwards, *et al.*)
Budget and Taxation

Commerce, Housing, and Community Development - Opportunity Zones

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This bill generally extends the geographic eligibility for a number State of economic development/tax credit and financing programs available for priority funding areas (PFAs) and/or sustainable communities to include Opportunity Zones. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: General fund revenues decrease significantly beginning in FY 2020 due to credits/deductions claimed against the personal and corporate income tax. Transportation Trust Fund (TTF) and Higher Education Investment Fund (HEIF) revenues decrease beginning in FY 2020 to the extent credits are claimed against the corporate income tax. General fund expenditures increase, potentially significantly, for local property tax credit reimbursements, likely beginning in FY 2021, to the extent additional local credits are claimed under the Enterprise Zone Program.

Local Effect: Local revenues decrease beginning in FY 2020 from income and property tax credits/deductions, mitigated to some extent by State reimbursements under the Enterprise Zone Program and potential State financial program assistance. Local expenditures increase to the extent any State financial program assistance is received and used.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The geographic eligibility requirements for the specified economic development/tax credit and financing programs, which are generally limited to PFAs and/or sustainable communities, but may include further requirements, are expanded to include Opportunity Zones. The following programs are affected:

- Arts and Entertainment Districts
- Enterprise Zones
- Base Revitalization and Closure (BRAC) Zones
- Job Creation Tax Credit
- One Maryland Tax Credit
- Businesses that Create New Jobs Tax Credit
- Community Legacy Program (sustainable communities)
- Neighborhood Business Development Program
- Strategic Demolition and Smart Growth Impact Fund (sustainable communities)

The bill also loosens restrictions on providing funding without Board of Public Works approval for specified "growth-related projects" and Sunny Day projects outside of PFAs.

Current Law/Background: The economic development programs specified in the bill are generally administered by either the Department of Commerce (Commerce) or the State Department of Assessments and Taxation while the financing programs are administered by the Department of Housing and Community Development (DHCD). For most of the programs, in addition to meeting other requirements, the business or activity must be located in a PFA, although some of the financing programs require the business to be in a sustainable community, which is a subset of a PFA targeted for revitalization.

Economic Development Programs

The economic development programs offer a variety of income and property tax benefits for individuals or businesses that qualify under them. Not all benefits are described here.

Several tax benefits are available in arts and entertainment districts. Qualifying residing artists may claim an income tax deduction on State and local income taxes for the income derived within the district from the publication, production, or sale of artistic work created by the qualifying artist. A local government may grant a property tax credit against specified related property, and may exempt certain sales from the admissions and amusement tax.

BRAC Zone designation benefits are primarily tax-related financial incentives, including State support of up to 100% of the increase in the State property tax of any qualifying property and 50% of the local property tax for any increase in the local tax revenues collected on the increased value of qualifying property. These financial incentives were authorized to begin in fiscal 2010 and the benefits are available for 10 consecutive years; they are limited to the amount appropriated in the State budget, up to $5.0 million per year.

Under the Enterprise Zone Program, businesses located or locating in an enterprise zone may receive a 10-year property tax credit against local real property taxes. The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property improvements. The State reimburses local governments for one-half of the cost of the property tax credit – averaging about $26.1 million annually from fiscal 2018 through 2020. Income tax credits are also available. Enterprise Zones must be designated by the Secretary of Commerce and must be located in PFAs.

Under the One Maryland Program, certain businesses located in PFAs in certain economically distressed ("Tier I") counties may claim a State income tax credit of up to $5.0 million. Smaller $2.5 million and $1.0 million credits are also available. Through December 2017, Commerce had certified a total of $285.4 million in One Maryland tax credits.

The Businesses that Create New Jobs Tax Credit Program authorizes a county or municipality to grant property tax credits against real and personal property taxes for a business located in Maryland that creates new positions and establishes or expands business facilities in the State. The new or expanded premises must be located in a PFA and meet other specified requirements.

The Economic Development Opportunities (better known as Sunny Day) Program provides conditional loans and investments intended to take advantage of extraordinary economic development opportunities, defined in part as situations that create or retain a substantial number of jobs and where a considerable private investment is leveraged. The Sunny Day Fund is a fund under the State Reserve Fund.

Financing Programs

The Community Legacy Program provides local governments and community development organizations with funding for essential projects aimed at strengthening communities through activities such as business retention and attraction, encouraging homeownership, and commercial revitalization. Funding can only be used in sustainable communities.

The Neighborhood Business Development Program, operating publicly as Neighborhood BusinessWorks, provides grants and loans to community-based economic development activities in revitalization areas designated by local governments. The program is available to businesses located in PFAs and sustainable communities. The Strategic Demolition Fund aims to improve the economic viability of "grey field development" which often faces more barriers than sprawling "green field development." Since funds are limited, awards focus on those smart growth projects that can have a high economic and revitalization impact in their existing communities. Projects must be located in sustainable communities. Eligible applicants include local governments and nonprofit community development organizations.

Opportunity Zones

The Federal Tax Cuts and Jobs Act of 2017 established the Qualified Opportunity Zones Program to incentivize private investment in distressed communities. Under the Act, states may nominate up to 25% of specified low-income census tracts for designation by the U.S. Treasury as Opportunity Zones. Maryland designated zones in 2018, as shown in the **Appendix – Maryland Qualified Opportunity Zones**. The Administration has also established the Opportunity Zone Leadership Task Force by executive order to provide guidance and coordinate efforts related to Opportunity Zone investment.

A qualified Opportunity Fund is a privately managed investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified Opportunity Zone property and that holds at least 90% of its assets in such property. Qualified Opportunity Zone property includes stock, a partnership interest, and tangible property used in a trade or business.

The program offers three federal tax incentives related to capital gains: (1) a temporary tax deferral for capital gains reinvested in an Opportunity Fund; (2) a step up in basis for capital gains reinvested in an Opportunity Fund, which excludes up to 15% of the original capital gain from taxation; and (3) a permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund, if the investment is held for at least 10 years. More information on the tax incentives, including helpful illustrative examples, can be found on the Economic Innovation Group's website.

Expansion of Geographic Eligibility to Opportunity Zones

PFAs are predominantly located in the center of the State or in compact municipal clusters in the State's more rural counties. PFAs also trend toward granularity in their geographic boundaries; *i.e.,* the shapes are not uniform and tend to target relatively specific areas. Sustainable communities, arts and entertainment districts, Enterprise Zones, and other similar areas are also generally located wholly within PFAs. In contrast, Opportunity Zones are designated census tracts, which tend to be larger in area, with less population density, and have more uniform boundary lines. Each county in the State has at least one Opportunity Zone, and generally, the more rural the area, the larger the zone(s).

Most Opportunity Zones in the center of the State entirely overlap existing PFAs, while Opportunity Zones in the more rural counties have less overlap. As a result, the bill generally expands eligible geographic areas for the specified economic development and financing programs to include more areas in predominantly rural counties, although there are some exceptions. A preliminary analysis of available data indicates that about 20 to 25 Opportunity Zones are added to the overall geographic area, representing about 2% of the State's adult population.

A map showing the areas newly eligible under the bill can be found in the **Appendix – Priority Funding Areas and Opportunity Zones.** An interactive map, which includes layers for PFAs, sustainable communities, and Opportunity Zones, is also available online.

State Fiscal Effect: Expanding the geographic eligibility for economic development/tax credit programs likely leads to additional tax incentives provided through those programs. While a precise estimate of the revenue effect cannot be made at this time, the two programs that most likely have significant fiscal effects are the Enterprise Zone Program and the One Maryland Program, because they are the larger programs affected by the bill, have no budgeted cap, and offer relatively large incentives.

Even a minor expansion of the number of One Maryland projects, which can each claim an income tax credit of up to $5.0 million, decreases State revenues by at least several million dollars annually due to credits taken against the personal and corporate income tax. Therefore, general fund and special fund revenues decrease significantly beginning in fiscal 2020. TTF and HEIF revenues decrease beginning in fiscal 2020 to the extent credits are claimed against the corporate income tax.

In addition to relatively modest income tax incentives, the Enterprise Zone Program also offers valuable local property tax credits. The State reimburses local governments for half of the costs, an expenditure averaging about $26.1 million annually in recent years. Independent of the bill's revenue effect, a 10% expansion of the program increases general fund expenditures by $2.6 million annually. It is assumed that a delay in Enterprise Zone designations delays the effect to at least fiscal 2021.

Generally, altering the geographic eligibility requirements for DHCD's financing programs does not materially affect State finances or operations, although it may alter the allocation of funds between recipients.

State agencies can handle the bill's operational requirements with existing budgeted resources.

Local Fiscal Effect: Local revenues decrease from additional income tax credits/deductions and property tax credits taken under various economic development programs expanded under the bill beginning in fiscal 2020. The effect on a particular local government cannot be reliably estimated at this time, but could be significant. Local revenues increase from State reimbursements for local property tax credits under the Enterprise Zone Program, which is assumed to happen no earlier than fiscal 2021. Local revenues may also increase from program funds awarded under the Strategic Demolition Fund.

Local governments most likely to be affected are those with significant Opportunity Zone areas that are not already within a PFA or sustainable community.

Small Business Effect: Small businesses that qualify for economic development incentives or financial assistance under the bill benefit from the assistance provided under the affected programs. The effect on any particular business is unknown, but could be significant. Conversely, businesses located outside of Opportunity Zones may receive less or no assistance, and may have to compete against those businesses that do.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Commerce; Department of Housing and Community Development; Board of Public Works; State Department of Assessments and Taxation; Department of Information Technology; Charles, Frederick, and Montgomery counties; City of Havre de Grace; Maryland Association of Counties; Maryland Municipal League; Economic Innovation Group; Department of Legislative Services

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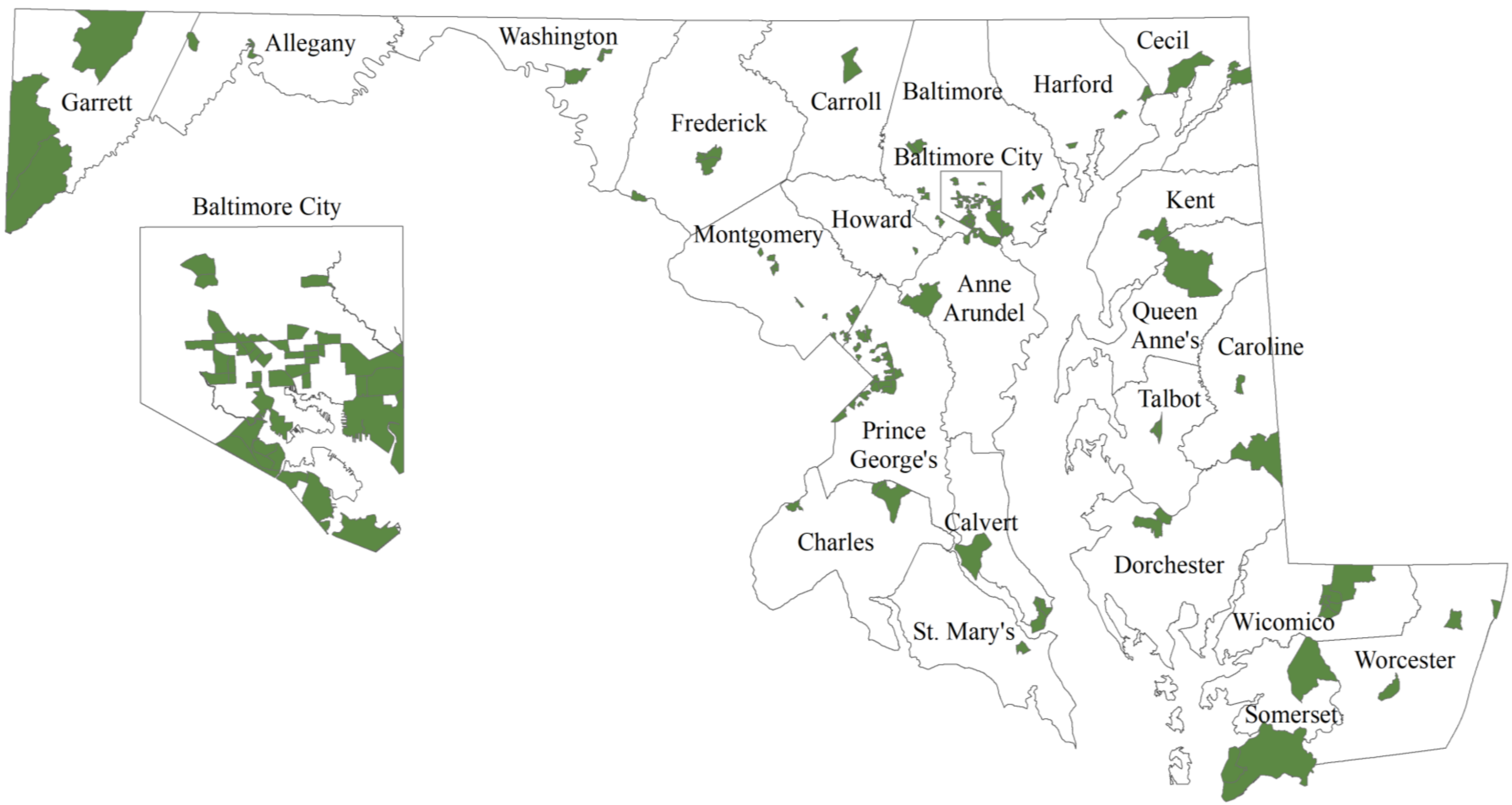
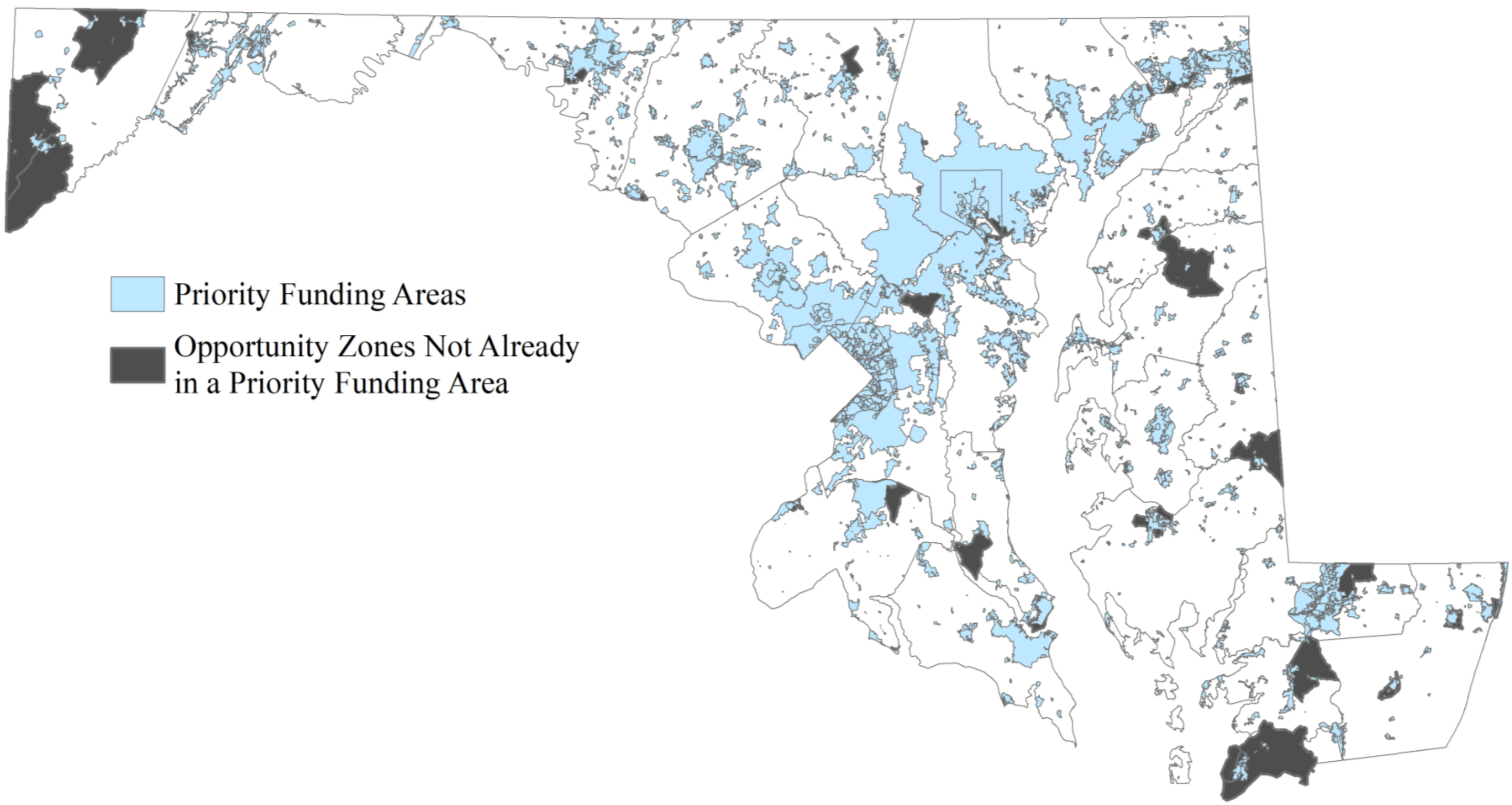
Appendix – Maryland Qualified Opportunity Zones



Source: Department of Information Technology (MD iMAP)

Appendix – Priority Funding Areas and Opportunity Zones



Note: Does not show sustainable communities or enterprise zones, which are subsets of priority funding areas. Enterprise zones are the smallest of the three areas.
Source: Department of Information Technology (MD iMAP)