Maryland
DEPARTMENT OF COMMERCE

Larry Hogan | Governor
Boyd Rutherford | Lt. Governor
Kelly M. Schulz | Secretary of Commerce

DATE: **March 5, 2020** **COMMITTEE: House Ways and Means**
BILL NO: **House Bill 1284**
BILL TITLE: **State Tax Credits, Exemptions, and Deductions - Alterations and Repeal (Tax Modernization Act)**
POSITION: **Oppose**

The Maryland Department of Commerce (Commerce) opposes House Bill 1284 – State Tax Credits, Exemptions, and Deductions - Alterations and Repeal (Tax Modernization Act).

Bill Summary:
Among other changes to tax policy, HB 1284 would make the following changes to certain tax incentive programs administered by Commerce:

- One Maryland Tax Credit – alters the program so it would no longer be a refundable tax credit
- Aerospace, Electronics, or Defense Contract Tax Credit Program – alters the program so it would no longer be a refundable tax credit, and allows the qualified business entity to apply any remaining credit in future taxable years until the full amount of the credit is claimed
- Film Production Activity Tax Credit – alters the program so Commerce would no longer be able to apply any unused credits under the maximum allowable amount for a fiscal year to be applied toward increasing the maximum amount for the next fiscal year
- Employer Security Clearance Costs Tax Credit – alters the program to make it available only to small businesses, defined as a firm that is independently owned and operated, not a subsidiary of another firm, not dominant in its field of operation, and did not employ more than 25 individuals
- Cybersecurity Investment Incentive Tax Credit - alters the program so it would no longer be a refundable tax credit, and to allow the qualified business entity to apply any remaining credit in future taxable years until the full amount of the credit is claimed. Also reverts any unused funds in the Reserve Fund to the General Fund at the end of the fiscal year
- More Jobs for Marylanders Tax Credit Program - alters the program so it would no longer be a refundable tax credit, and to allow the qualified business entity to apply any remaining credit in future taxable years until the full amount of the credit is claimed. Also reverts any unused funds in the Reserve Fund to the General Fund at the end of the fiscal year

Rationale:
One Maryland Tax Credit
Reducing the usefulness of the credit will have a negative effect on the ability of Commerce to use it as a tool to attract and retain businesses in distressed communities with high unemployment and lower incomes.

Aerospace, Electronics, Or Defense Contract Tax Credit Program
Reducing the usefulness of the credit will have a negative effect on the ability of Commerce to use it as a tool to attract and retain businesses.

Film Production Activity Tax Credit
Beginning in FY 2019 10% of the maximum authorized credit for a fiscal year was reserved for small and independent Maryland film entities. Since that time only one application has been received from a small film entity. *Hope's Legacy* applied on February 14, 2019 and based on the application would potentially qualify for a maximum credit of $61,430.00. Prior to the enactment of the Small and Independent Film Entity set-aside, the Film Production Activity Tax Credit had not carried forward any funds, as all funds have been expended in the year they were appropriated. This change will negatively impact the ability of the Department to attract and retain film productions as it creates additional uncertainty as to how much will be available in a given fiscal year. As many productions take place over multiple years, all production-related costs may not be able to be incurred in the year that the production company initially plans them to be. Removing the flexibility of the tax credit to respond to these issues will make it less useful and desirable to film production companies, making Maryland a less desirable place to do business.

Employer Security Clearance Costs
The changes proposed to the Employer Security Clearance Costs tax credits will benefit small businesses, which will receive the full value of tax credits for which they apply as the tax credit is oversubscribed. However, making the credit only for small businesses may negatively affect the decision making of large defense industry employers in the State. Eliminating the incentive for large employers may adversely affect their decision to maintain or expand operations in Maryland. Additionally, setting the limit at 25 employees would eliminate many of the companies who have qualified for the program in the past from eligibility. For reference, of the 73 companies certified in Tax Year 2017 (the most recent complete year for which data is available), only 24 had 25 or fewer employees, while 58 had 100 or fewer employees.

Cybersecurity Investment Incentive
Removing the refundability of this incentive will negatively affect the ability of Commerce to assist Maryland cybersecurity companies in attracting investment from outside the State. Investors with no Maryland tax liability will not be able to realize benefits from the program, and therefore will not make important investments.

More Jobs for Marylanders
Reducing the usefulness of the credit will have a negative effect on the ability of Commerce to use it as a tool to attract and retain businesses. In addition, removing the refundability provision of the program makes it impossible for a non-profit organization located within an opportunity zone to take advantage of it. Lastly, altering the Reserve Fund so any unused funds at the end of the fiscal

year revert to the General Fund will only serve to increase the appropriation necessary in future fiscal years in order to cover additional benefit years for applicants who have already been certified as well as to allow a buffer for potential new qualified applicants. Each year Commerce projects the amount of funding necessary for the upcoming fiscal year and tries to make as conservative of a projection as possible in order to assist the Governor in determining how much to appropriate to the Fund. Should this bill pass the Department would likely assume a maximum of $9M in new initial income tax credit certificates in each year in addition to continuation of benefits for companies already approved in order to ensure there is not a shortfall in the Reserve Fund.

"Economic development is about positioning the economy on a higher growth trajectory . . . it is the product of long-term investments in the generation of new ideas, knowledge transfer, and infrastructure, and . . . requires collective action and large-scale, long-horizon investment." In short, "economic development addresses the fundamental conditions necessary for the microeconomic functioning of the economy."[1]

The major thrust of most economic development programs is the carefully applied incentives to shape certain, important economic investments that can benefit the State's citizens and place its economy on the aforementioned "higher growth trajectory." Maryland, like all other states, uses economic development incentives to attract and retain jobs and investment and to help grow important industry sectors.

Maryland is in direct competition with both other U.S. states and with the rest of the world. Our business attraction and retention efforts don't lead with incentives, but with our optimal location, highly-educated workforce, and unique State resources. All things being equal, these characteristics would be enough to attract and retain jobs and investment to the State. However, all things are not equal.

Maryland's current programs are barely competitive with other states. The State of Maryland spends half what neighboring Virginia and only 40 percent of what Pennsylvania spends on incentives. Maryland's state incentive spending pales in comparison to the $1.3 billion spent by the State of New York in FY2020.

We at Commerce understand the importance of a highly-educated workforce, and how a properly-funded educational system contributes to that. However, we cannot cut our way to better education. The best way to fund the recommendations of the Kirwan Commission is to grow the economy and to increase the personal income of Marylanders, and the only way to do that is to make investments in business growth and attraction.

The programs that HB 1284 seeks to alter are designed to revitalize <u>distressed</u> areas, attract investment and job creation in key industries, and support our highly educated workforce. Even with Maryland's constrained spending as compared to other states, its programs have had successes in attracting and retaining businesses and in assisting the growth of key industry sectors.

In today's constrained fiscal climate, we must all do more with less. We at Commerce believe that these programs are the most efficient method for incentivizing capital investments, job retention,

[1] https://www.eda.gov/files/tools/research-reports/investment-definition-model.pdf

and job growth across the State. While all programs should be reviewed periodically to ensure that they are fulfilling their missions, the wholesale elimination of necessary and successful programs without any review process is a recipe for economic failure. The best way to restructure incentives for optimal impact is to create an inclusive, deliberative process that carefully reviews each program to see how it fits into the larger goal of positioning Maryland's economy on a higher growth trajectory, much like the State did in 2000 when the Department's discretionary financing programs were modernized and consolidated.

Commerce respectfully requests an unfavorable report on House Bill 1284.