Maryland General Assembly
Department of Legislative Services

Proposed Regulation
Department of Business & Economic Development
(DLS Control No. 15-169)

Overview and Legal and Fiscal Impact

These regulations expand eligibility for the biotechnology investment tax credit by classifying specified convertible debt as an investment eligible for the tax credit.

The regulations present four legal issues of concern of which the Department of Business and Economic Development has been notified. Please see the Legal Issues section of the Legal Analysis below for additional comments.

Regulations of COMAR Affected

Department of Business & Economic Development:
Economic Development: Biotechnology Investment Incentive Tax Credit:
COMAR 24.05.03.02 and .06

Legal Analysis

Background

Established in 2005, the biotechnology investment tax credit offers a refundable tax credit for investments in qualified biotechnology companies. The Department of Business and Economic Development (DBED) administers the tax credit application, approval, and certification process and must submit a report to the Governor and the General Assembly detailing specified information about the tax credit each year. An investor who invests at least $25,000 in a qualified Maryland biotechnology company may claim a credit equal to 50% of the investment, not to exceed $250,000. The department may not certify investments in a single biotechnology company that total more than 15% of the total appropriations to the reserve fund for that fiscal year.

Chapters 75 and 76 of 2013 expanded the eligibility for the biotechnology investment tax credit. The Acts specified that a biotechnology company that has been in active business for up to 10 years from the date the company first received a qualified investment for purposes of the tax credit may qualify as a biotechnology company and be eligible to receive investments for which tax credits can be awarded.

Senate Bill 351 and House Bill 950 of 2015 (both failed) would have made a change to the cybersecurity investment incentive tax credit that is similar to the changes proposed in these regulations. Specifically, the bills would have allowed convertible debt to qualify as an investment for the cybersecurity investment incentive tax credit.

Summary of Regulations

The regulations expand the scope of the biotechnology investment tax credit by classifying specified convertible debt as investments eligible for the tax credit. The regulations define convertible debt as "a debt, bond, or loan issued by a qualified Maryland biotechnology company to a qualified investor for a contemporaneous exchange of cash or cash equivalents expressed in United States dollars, at a risk of loss, convertible into a specified amount of stock, partnership or membership interests, or other ownership interest." Convertible debt may be classified as an investment if the debt is: (1) created by the qualified investor applying for an initial certificate of eligibility for the tax credit on or after July 1, 2015; (2) created no more than one year prior to the investor applying for an initial certificate of eligibility for the tax credit; and (3) converted to a specified interest within 30 days after the issuance of an initial tax credit eligibility certificate and prior to the issuance of a final tax credit eligibility certificate. The regulations also specify the manner in which an investor may provide evidence of the convertible debt.

Legal Issues

The regulations present four legal issues of concern. The Department of Legislative Services contacted the department to express concern with the statutory authority cited for the regulation; the regulations' compliance with the legislative intent of the law; the retroactive nature of the regulations; and the publication of the regulations' proposed changes on the department's website as current law. The department maintained its position that it had the statutory authority for the regulations and was only clarifying an ambiguous definition. The department failed to respond to concerns regarding the retroactive nature of the regulations and the publication of the regulations' proposed changes as current policy.

Statutory Authority

In the discussion between the Department of Legislative Services and the department, the Department of Legislative Services indicated that the statutory authority for the regulations may be insufficient and that the regulations may not comply with the legislative intent of the law. Section 10-725(i) of the Tax – General Article requires the adoption of regulations to (1) carry out the tax credit and (2) specify criteria and procedures relating to the application for the tax credit, approval of the tax credit, and monitoring continuing eligibility for the tax credit. The Department of Legislative Services noted that § 10-725(i) relates to the specification of criteria for the application and approval for the tax credit. The changes proposed in the regulations are changes to the definitions outlined in statute, not changes to the criteria for the tax credit. Under the authority of § 10-725(i), the department has promulgated additional criteria related to the application for the tax credit. For example, COMAR 24.05.03.14(D)(4)(c) requires a biotechnology company to have "competent management." The Department of Legislative Services advises that the statutory authority cited by the department may be insufficient to alter a statutory definition.

Legislative Intent

In addition to the concern regarding statutory authority, the Department of Legislative Services advises that the regulations do not comply with the legislative intent of the law. Section 10-725 explains at length the eligibility process for the tax credit, including the requirements needed to apply for the tax credit and the process for the submission and approval of an application. More specifically, § 10-725(a)(5) provides a precise definition of investment:

> (i) "Investment" means the contribution of money in cash or cash equivalents expressed in Unites States dollars, at a risk of loss, to a qualified Maryland biotechnology company in exchange for stock, a partnership or membership interest, or other ownership interest in the equity of the qualified Maryland biotechnology company, title to which ownership shall vest in the qualified investor.
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> (ii) "Investment" does not include debt.
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> (iii) For purposes of this section, an investment is at risk of loss when its repayment entirely depends upon the success of the business operations of the qualified company.

The regulations alter the statutory definition of investment to include certain convertible debt created on or after July 1, 2015 and to exclude "any other form of debt." This alteration of the definition directly conflicts with § 10-728(a)(5)(ii), which explicitly states that investment does not include debt. Notwithstanding the one year time limitation that would apply to convertible debt that is eligible for the tax credit, the regulations fundamentally alter the definition by allowing an investor to have a debt, bond, or loan in a qualified Maryland biotechnology company and qualify for the tax credit. The regulations also alter the procedure by which a qualified investor must apply for the tax credit. In statute, a qualified investor must submit an application for the tax credit to the department at least 30 days prior to making an investment in a qualified Maryland biotechnology company. Under the regulations' revised definition of investor, a qualified investor could agree to a debt, bond, or loan that may be eligible for the tax credit before having to submit an application to the department. The regulations' change to the statutory eligibility for the tax credit, in addition to the statutory procedure for claiming the tax credit, present concerns that the regulations do not comply with the legislative intent of the law. The Department of Legislative Services notes that a prior change to the statutory definition of "qualified Maryland biotechnology company" was made through legislation in Chapters 75 and 76 of 2013. In addition, the General Assembly rejected a similar attempt to alter the definition of investment to include convertible debt for the cybersecurity investment tax credit during the 2015 legislative session (see Senate Bill 351 and House Bill 950).

Retroactive Nature

As discussed in the Summary of Regulations section above, the regulations classify certain convertible debt as an investment if it was created by the qualified investor applying for an initial certificate of eligibility for the tax credit on or after July 1, 2015. The department did not file the regulations with the AELR Committee until August 3, 2015, and the department intends to first publish the regulations on September 18, 2015. Therefore, the department likely would not adopt the regulations before November 3, 2015. The Department of Legislative Services advises that the date of eligibility for the convertible debt would be months prior to the adoption of the regulations.

Publication of the Proposed Changes as Current Policy

The Department of Legislative Services notes that the department has updated its website to reflect the proposed changes to the tax credit as current policy. The update to the website was made prior to the department publishing the regulations and does not indicate that the regulations in which the changes are included have not yet been adopted. Specifically, the website states the following:

> New Policy Change Effective July 1, 2015
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> Beginning July 1, 2015, convertible debt created on or after July 1, 2015 will qualify for the Biotechnology Investment Incentive Tax Credit provided that the conversion to equity ownership (common or preferred stock) occurs within 30 days after the issuance of an Initial Tax Credit Certificate by DBED and prior to the request for a Final Tax Credit Certificate. After June 30, 2016, convertible debt must have been created within one year prior to the date of an investor's application for a Biotechnology Investment Incentive Tax Credit.
> (http://business.maryland.gov/fund/programs-for-businesses/bio-tax-credit,
> accessed August 11, 2015)

Moreover, according to the department, the opportunity for public comment for these regulations will not end until October 19, 2015. The publication of the contents of the regulation as current policy on the department's website may confuse the public and alter the participation of the public during the public comment period.

Statutory Authority and Legislative Intent

The department cites § 2-108 of the Economic Development Article and § 10-725 of the Tax – General Article as authority for the regulations. Section 2-108 broadly authorizes the Secretary to adopt regulations for the Office of the Secretary. Section 10-725 requires the department and the Comptroller jointly to adopt regulations "to carry out the biotechnology investment tax credit and to specify criteria and procedures for application for, approval of, and monitoring continuing eligibility for the tax credit."

The concerns with the authority and compliance with legislative intent are expressed in the Legal Issues section above. As such, the Department of Legislative Services advises that the regulations do not comply with the legislative intent of the law.

Fiscal Analysis

The regulations alter the type of "investment" (as defined in regulation) for which the Biotechnology Investment Incentive Tax Credit is available. There is minimal or no fiscal impact on State or local agencies.

Agency Estimate of Projected Fiscal Impact

The department advises that the regulations have minimal or no impact on State or local governments. While the regulations alter the type of "investment" (as defined in regulation) for which the Biotechnology Investment Incentive Tax Credit is available, the total funding for the tax credit is limited through a budgetary appropriation. The Department of Legislative Services concurs and notes that, generally, the total amount of initial tax credit certificates issued by the department in each fiscal year cannot exceed the amount appropriated in the State budget to the Maryland Biotechnology Investment Tax Credit Reserve Fund. However, any unexpended funds from a fiscal year remain in the reserve fund and may be issued under initial tax credit certificates in the next fiscal year. The fiscal 2016 appropriation for the tax credit is $12 million.

Impact on Budget

There is no impact on the State operating or capital budget.

Agency Estimate of Projected Small Business Impact

The department advises that the regulations have minimal or no economic impact on small businesses in the State. The Department of Legislative Services concurs.

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