SB 219

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 219 (The President, *et al.*) (By Request – Administration)
Budget and Taxation

Business and Economic Development - Biotechnology Investment Incentive Act

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This Administration bill makes several changes to the existing biotechnology investment tax credit program related to eligibility for the credit, the maximum value of the credit, procedures for claiming the credit, and administrative aspects of the credit.

The bill takes effect July 1, 2006.

Fiscal Summary

State Effect: The impact on State revenues depends on the amount of credits approved in each year and cannot be reliably estimated at this time. If an average of $6 million in credits are awarded annually in tax years 2007 through 2011, State revenues could increase by approximately $3 million in FY 2008, $6 million annually in FY 2009 and FY 2010, and by $5 million in FY 2011 due to credits being claimed later than provided under current law. These revenue increases represent a change in the timing of when credits are claimed and do not represent an overall decrease in the cost of the tax credit program. Expenditures would not be affected.

Local Effect: Local government revenues would increase beginning in FY 2008 as a result of fewer tax credit claims against the corporate income tax. Corporate income tax revenue is distributed 76% to the general fund and 24% to the Transportation Trust Fund (TTF). Of the 24% distributed to the TTF, approximately 30% is distributed to local jurisdictions in the form of local highway user revenues. No effect on expenditures.

Small Business Effect: A small business impact statement was not provided by the Administration in time for inclusion in this fiscal note. A revised fiscal note will be issued when the Administration's assessment becomes available.

Analysis

Bill Summary: The bill makes several changes to the existing biotechnology investment tax credit as described below:

- ***Imposes Eligibility Standards*:** To be eligible, an applicant cannot, after making an investment in a biotechnology company, own or control more than 20% of the biotechnology company or be a founder, principal, director, officer, member, or partner of the company.

- ***Alters Maximum Credit Value:*** The maximum proposed value of the credit for individuals is 10% of the total amount appropriated to the biotechnology investment tax credit reserve fund and 20% for corporations and venture capital firms.

- ***Alters How the Credit is Claimed:*** Under current law, the credit is refundable. The bill eliminates the refundability of the credit and requires that a taxpayer can claim the credit beginning in the third tax year in which a qualifying investment was made at a rate of one-third per tax year. Any unused credit amount can be carried forward eight tax years. The bill also repeals provisions regarding the recapture of the credit and instead requires the taxpayer to submit annually to the Department of Business and Economic Development (DBED): (1) information that the biotechnology company in which the qualified investment was made is still actively operating; (2) immediate notification of any information received that the biotechnology company is no longer operating; and (3) any tax return in which any portion of the credit is claimed. If the biotechnology company ceases operations, any unclaimed portion of the credit based on an investment in the company is forfeited.

- ***Administrative Aspects:*** DBED and the Comptroller's Office must adopt regulations that provide for tax credit allocation in a fiscal year when either qualified applicants apply for the credit at the same time and are together eligible for an amount that exceeds the appropriation to the reserve fund in that year or when tax credits become available because an applicant who was certified is no longer eligible. DBED may not certify investments in a single biotechnology company in a fiscal year that exceeds the lessor of $2 million or 20% of the total appropriations to the reserve fund.

Current Law: A tax credit against the State income tax is available for individuals, corporations, and venture capital firms that invest in qualified biotechnology firms. The value of the credit is equal to 50% of an eligible investment made in a qualified biotechnology company during the taxable year. The maximum amount of the credit cannot exceed (1) $50,000 for individuals; and (2) $250,000 for corporations and venture capital firms. A taxpayer claiming the credit can claim a refund in the amount by which the credit exceeds the tax liability in the year. Tax credits can be claimed beginning in tax year 2007. The credit can be recaptured by the State if the investor sells the ownership interest in the company within two years of the close of the tax year when the credit was approved. The State can recapture: (1) 100% in the same year; (2) 67% one year after; and (3) 33% from one to two years after.

Background: Chapter 99 of 2005 established the biotechnology investment tax credit program. DBED administers the tax credit application, approval, and certification processes and is required to submit a report to the Governor and the General Assembly detailing specified information about the tax credit by January 10 of each year.

An eligible investment is an at-risk investment in exchange for stock or ownership interest. In order to be eligible for the tax credit, an individual must invest at least $25,000 in a qualifying company and a corporation must invest at least $250,000 in a qualifying company. A qualifying company can be either a biotechnology company or a venture capital firm. A qualifying biotechnology company is defined as a for-profit entity that (1) is primarily engaged in the research, development, or commercialization of technology related to biological material; (2) has been in business less than 10 years; (3) has less than 50 full-time employees; (4) has its headquarters and base principal place of operations in Maryland; and (5) is certified as a biotechnology company by DBED.

A qualifying venture capital firm is (1) organized for the purpose of investing in privately-held technology companies; (2) has its principal place of business in Maryland; (3) has at least one year of experience investing in biotech or biopharmaceutical companies; (4) has two principals that each have at least five years of venture capital experience; and (5) has at least one principal that has invested at least $5 million in Maryland biotechnology companies.

The total amount of initial credit certificates issued by DBED in each fiscal year cannot exceed the amount appropriated to the Maryland biotechnology investment tax credit reserve fund in the State budget. The Governor is required to include an appropriation (no specific amount is required) to the reserve fund in each budget bill. The Governor may not reduce an appropriation to the reserve fund that is approved by the General Assembly. For each fiscal year, if funds are transferred from the reserve fund as a result of any law, the amount of total credits that can be approved by DBED is reduced by the amount of money transferred. If funds to the reserve fund are not expended in a fiscal year, any unexpended amount can be used in the next fiscal year. The proposed fiscal 2007 budget provides $6 million to the reserve fund.

Within 15 days of the end of each calendar quarter, DBED is required to notify the Comptroller the total number of credits that were certified during the quarter, the total amounts of the maximum credit amount stated in the initial credit certificates, and the total amounts of final certified credit amount. Upon this notification from DBED, the Comptroller is required to transfer from the reserve fund to the general fund the total amounts stated in the final credit certificates that were certified during the calendar quarter.

State Revenues: The bill provides that credits are nonrefundable and may be claimed beginning in the third tax year in which a qualifying investment was made at a rate of one-third per tax year. The actual impact on State revenues will depend on the amount of credits awarded in each fiscal year and when taxpayers elect to claim the credit.

However, State revenues could increase by approximately $3 million in fiscal 2008, $6 million annually in fiscal 2009 and 2010, and $3 million in fiscal 2011 based on the following facts and assumptions:

- an average of $6 million annually in tax credits will be awarded in tax year 2007 through 2010; and

- under current law and the bill, one-half of credits will be claimed in the first fiscal year in which credits may be claimed and one-half will be claimed in the following fiscal year.

The estimated revenue gains represent a delay in the timing of when credits are claimed and do not represent an overall decrease in the cost of the tax credit program. Under the assumed schedule of when credits are claimed, this bill would not impact State revenues in fiscal 2014 and beyond. If taxpayers claim credits later than estimated as provided under current law, revenue increases will be less than estimated in fiscal 2008 and more in later fiscal years. The total impact on revenues would also depend on the amount of tax credits awarded in each fiscal year. To the extent that less credits are awarded in each tax year, State revenue gains in fiscal 2008 through 2011 would be less than estimated.

The bill also repeals existing tax credit recapture provisions and replaces them with annual reporting requirements and delaying when credits can be claimed. Any impact on revenues from this change is expected to be minimal, and other changes to the tax credit program are not expected to impact State revenues.

Additional Information

Prior Introductions: None.

Cross File: HB 321 (The Speaker, *et al.*) (By Request – Administration) – Ways and Means.

Information Source(s): Department of Business and Economic Development, Comptroller's Office, Department of Legislative Services

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