SB 976

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE

Senate Bill 976 (Chair, Budget and Taxation Committee)
(By Request – Departmental – Business and Economic Development)
Budget and Taxation

Business and Economic Development - Biotechnology Investment Incentive Act

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

The bill takes effect July 1, 2007 and applies to tax year 2008 and beyond.

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 2008 through 2011, State revenues could increase by $4.5 million in FY 2009, $6.0 million in FY 2010, and $3.0 million in FY 2011. Revenues would be affected minimally in FY 2012 and beyond. These 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.

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	$0	$4.5	$6.0	$3.0	$0
Expenditure	$0	$0	$0	$0	$0
Net Effect	$0	$4.5	$6.0	$3.0	$0

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

Local Effect: Local government revenues would increase beginning in FY 2008 as a result of fewer tax credits being claimed against the corporate income tax. Local revenues would be affected minimally in FY 2012 and beyond. No effect on expenditures.

Small Business Effect: The Department of Business and Economic Development (DBED) has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment.

Analysis

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

Alters Eligibility Standards

To be eligible, an applicant cannot, prior to making an investment in a biotechnology company, own more than 25% of the biotechnology company. An applicant also cannot be: (1) a founder, shareholder, principal, director, officer, member, general partner, or owner of an equity interest in the biotechnology company; or (2) a parent, spouse, or child of any of these individuals.

The bill also provides that an investor seeking a tax credit must provide proof of making the investment. If the investor does not provide this notice within 40 days of the issuance of an initial tax credit certificate, DBED would rescind the certificate. Rescinded credits would revert to the reserve fund and will be available for reallocation in the same fiscal year by DBED.

The bill limits qualifying investments to cash or cash equivalents, and must be an at-risk investment in exchange for an ownership interest in the equity of the biotechnology company, title to which must vest in the qualified investor. Investments from specified retirement plans, or fiduciaries or custodians under those plans or similar tax-favored plans would not qualify for the tax credit. Debt or debt securities convertible into stock are not qualifying investments.

Under current law, a qualifying biotechnology company cannot have been in active business longer than 10 years. The bill proposes that a qualifying company cannot have been in existence in the jurisdiction in which it is organized for more than six years. This limit applies to related predecessor organizations. In addition, a biotechnology company cannot be a publicly traded company.

In order to eligible for the credit, an investor must be: (1) current in all State and local tax obligations; (2) not in default in any State or local contract; and (3) for companies, be in "good standing" with the jurisdiction in which its is organized and with the State and authorized or registered to do business in the State.

Alters How Credits are Claimed and Awarded

Under current law, individuals can claim a maximum credit of $50,000 and corporations and venture capital firms (subject to certain qualifications which the bill eliminates) can claim a maximum credit of $250,000. The bill alters these provisions and provides that any company, except a sole proprietorship, can claim a maximum credit of $250,000.

DBED 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. The bill requires that a taxpayer cannot claim the credit until the second tax year after the tax year in which the investment was made; at a rate of one-half per tax year.

Compliance Measures

The bill replaces the current provisions providing for recapture of the credit with the following measures:

- If before the second tax year after the year in which the investment was made, an investor sells or transfers of the equity interest all unclaimed credits outstanding would be forfeited, and any amount claimed would be recaptured. This provision does not apply if the transfer: (1) results from a testate or intestate succession, or under the terms of an intervivos trust, by reason of the death of the investor; or (2) is in exchange solely for the securities of an entity acquiring an interest amounting to 80% or more of the outstanding equity interests in the biotechnology company.

- Any unclaimed credits would also be forfeited if the biotechnology company in which a qualifying investment was made ceases to operate at any time before the end of the second tax year after the investment was made.

- An investor must provide specified evidence that the biotechnology remains in operation and that the investor continues to hold a qualifying equity interest in order to retain eligibility for the credit.

DBED and the Comptroller's Office are to jointly adopt regulations that specify the criteria and procedures related to the application and approval processes and for monitoring continuing eligibility for the tax credit.

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. The Department of Business and Economic Development (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.

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.

The proposed fiscal 2008 State budget provides $6 million to the reserve fund, which is how much the program received in fiscal 2007. DBED advises that all but $47,622 had been allocated as of December 31, 2006 and that this remaining amount has or will be awarded on a first-come first-served basis. DBED awarded initial credit certificates to 181 of 221 applicants. Of the successful applicants, 148 were from Maryland. Investments were made in approximately 20 qualifying biotechnology companies. Companies located in Montgomery County attracted a little more than one-half of all qualifying investments while the remaining investments were split between Baltimore County (about one-third), Baltimore City (about 10%), Howard County (about 8%) and Frederick County (less than 1%). Two-thirds of all investment was made in four companies, and a little more than one-fifth ($1.3 million) was invested in one company. The number of initial credit certificates issued by amount was: $12,500 or less (73), $12,500 to $25,000 (54), $25,001-$50,000 (44), and $250,000 or more (10).

State Revenues: The bill makes several changes to the program effective tax year 2008. The only change expected to materially impact State revenues is altering how the credit can be claimed. The actual impact on State revenues would depend on the amount of credits awarded in each fiscal year and when taxpayers would claim the credit under current law and as proposed under the bill. Tax year 2006 was the first year credits could be claimed, and the Comptroller's Office does not have data on how much has been claimed. However, State revenues could increase by $4.5 million in fiscal 2009, $6.0 million in fiscal 2010, and $3.0 million in fiscal 2011 based on the following facts and assumptions:

- an average of $6 million annually in tax credits will be awarded beginning in tax year 2008; and
- under current law, it is estimated that taxpayers would claim 75% of the credit in the current fiscal year and 25% in the next 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 provision would not impact State revenues in fiscal 2012 and beyond. If taxpayers claim credits later than estimated as provided under current law, revenue increases will be less than estimated in fiscal 2009 and 2010 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 would be less than estimated.

Any impact on revenues from other changes to the tax credit program are not expected to substantially impact State revenues.

Additional Information

Prior Introductions: SB 219/HB 319 of 2006, similar bills, were not reported from the Senate Budget and Taxation Committee and House Ways and Means Committee, respectively.

Cross File: None.

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

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ncs/hlb

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