HB 1007

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE

House Bill 1007 (Delegate Feldman)
Ways and Means

Biotechnology Investment Tax Credits

This 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 2007 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 2007 through 2011, State revenues could increase by $1.6 million in FY 2008, $1.1 million in FY 2009, and $430,000 in FY 2010 due to credits being claimed later than provided under current law. Revenues would be affected minimally in FY 2011 and beyond. 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 credits being claimed against the corporate income tax. Local revenues would be affected minimally in FY 2011 and beyond. No effect on expenditures.

Small Business Effect: Minimal.

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, prior to making an investment in a biotechnology company, own more than 25% of the biotechnology company. An applicant also cannot be a person, officer, director, manager, or general partner of the company. Under current law, "property" investments qualify for the credit. The bill limits qualifying investments to cash, and this cash must be an at-risk investment in exchange for stock or an interest in a qualifying biotechnology company or a qualifying convertible debt instrument issued by a biotechnology company.

- *Alters Maximum Credit Value:* No more than $2 million in total credits can be awarded for investments made in any one biotechnology company. The maximum value of the credit for qualifying venture capital firms would increase from $250,000 to $1 million.

- *Allows Insurers to Claim Credit:* Insurance companies making qualifying investments are eligible to claim the credit against the insurance premium tax.

- *Alters How the Credit is Claimed:* Under current law, the credit is refundable. The bill eliminates the refundability of the credit beginning with investments made after December 31, 2006. Any unused amount of the credit can be carried forward indefinitely until the full amount of the credit is claimed.

- *Alters Administrative Aspects:* Under current law, a venture capital firm can qualify if at least two principals have at least five years venture capital experience. The bill clarifies that these two principals must have five years of experience managing venture capital investments made with money raised from unaffiliated investors. The bill provides that credits are earned and vested when the qualifying investment is made, and provides for the allocation of the credit amongst members of a partnership or limited liability company.

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 2007. The only change expected to materially impact State revenues is altering the credit from a refundable to a nonrefundable credit. 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 $1.6 million in fiscal 2008, $1.1 million in fiscal 2009, and $430,000 in fiscal 2010 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, it is estimated that taxpayers would claim 75% of the credit in the current fiscal year and 25% in the next fiscal year. It is further estimated that under HB 1007, taxpayers would claim 45% of the credits in the current fiscal year, 34% in the second fiscal year, 13% in the third fiscal year, 7% in the fourth fiscal year, and 1% in the fifth fiscal year.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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