Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 106 (The President, *et al.*) (By Request - Administration)
Budget and Taxation Ways and Means

Labor and Employment - Job Creation and Recovery Tax Credit

This emergency Administration bill creates a tax credit against the State income tax for employers who hire qualified individuals between the effective date of the bill, and December 31, 2010. The value of the credit is equal to $5,000 per eligible employee hired, not to exceed $250,000 per taxpayer. The Department of Labor, Licensing, and Regulation (DLLR) is authorized to award $20 million in credits on a first-come, first-served basis. DLLR and the Comptroller's Office may jointly adopt regulations to carry out the provisions of the bill. DLLR is required to report to the Governor and the General Assembly specified information about the tax credit by April 1, 2011.

Fiscal Summary

State Effect: General fund revenues decrease by $19.0 million in FY 2011 and Transportation Trust Fund (TTF) revenues decrease by $1.0 million. General fund expenditures increase by $37,400 in FY 2011 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
GF Revenue	($19.0)	$0	$0	$0	$0
SF Revenue	($1.0)	$0	$0	$0	$0
GF Expenditure	$.0	$0	$0	$0	$0
Net Effect	($20.0)	$.0	$.0	$.0	$.0

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

Local Effect: Local highway user revenues decrease as a result of tax credits being claimed against the corporate income tax. Local revenues decrease by $305,500 in FY 2011. Expenditures are not affected.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The bill establishes a $5,000 tax credit for each individual hired by a qualified employer during calendar 2010. The tax credits may not exceed $250,000 per qualified employer or $20 million statewide. If the credit amount exceeds the tax liability, the taxpayer can claim a refund for the excess. The bill defines which employers and employees can qualify for the credit as well as establishing limits on the type of qualifying positions.

A qualified employee is defined as an individual who at the time of hiring: (1) is a State resident; (2) is receiving unemployment insurance benefits or has exhausted unemployment insurance benefits within the past 12 months; and (3) is not employed full time. Qualified employers include (1) persons conducting a trade or business in the State and filing Maryland income tax returns; or (2) nonprofit organizations. A qualified position is: (1) full-time; (2) expected to require the services of an employee for an indefinite duration and an uninterrupted period of at least 12 months; (3) located in the State; (4) newly created or has been vacant for a period of at least six months.

The credit may not be claimed if a job is the result of (1) the shift of an employment function within the entity's operations within the State; (2) a change in business ownership; (3) a business consolidation or restructuring, if the position is not a "net new job"; (4) a contractual shift from existing businesses; or (5) a "displacement" of an existing employee.

The bill establishes the tax credit application and certification process and establishes procedures for apportioning the credit among tax years and requirements necessary when the position for which the credit was claimed is vacated within one year of claiming the credit. DLLR is required to certify within 60 days of receiving an application that an employer and the position for which the credit is sought meet the eligibility requirements of the bill. Applicants seeking the credit are required to include specified information and make the application under penalty of perjury.

Current Law: Numerous federal and State tax credits are designed to promote employment. Some of these State credits are focused on specific groups and/or specific areas as discussed below. In addition to these State tax credits, businesses can typically deduct employee compensation costs; which typically lowers federal and State income tax liability.

Targeted Population Employment Tax Credits

Three State income tax credits – the Employment Opportunity, Long-Term Employment of Ex-Felons, and Maryland Disability Employment Tax Credits – offer businesses a tax credit for hiring certain populations. These credits are generally equal to a portion of the wages, up to a maximum amount, paid to qualified individuals.

Employment Opportunity (Work, Not Welfare Credit): An income tax credit is available to employers who hire an individual who is a recent recipient of temporary cash assistance for certain wages paid to the employee and for child care and transportation expenses paid on behalf of the employee in the first two years of employment. Employers can claim a credit equal to 30% of the first $6,000 of the wages paid to the employee (20% in year two). If the employee was a recipient of temporary cash assistance from the State for at least 18 of the last 48 months, the credit is equal to 40% of the first $10,000 in wages paid if the employee was employed for at least one full year. The credit can be claimed with regard to individuals hired through June 30, 2009.

Long-Term Employment of Ex-Felons: A business entity may claim a tax credit for wages paid to a qualified ex-felon employee. For each taxable year, a credit is allowed in an amount equal to: (1) 30% of up to the first $6,000 of the wages paid to the qualified ex-felon employee during the first year of employment; and (2) 20% of up to the first $6,000 of the wages paid to the qualified ex-felon employee during the second year of employment.

Maryland Disability Employment Tax Credit: Employers who hire a qualified individual with disabilities can claim a tax credit for certain wages paid to the employee and for child care and transportation expenses paid on behalf of the employee in the first two years of employment. The program terminates June 30, 2010.

Enterprise Zone Credit

Businesses located in a Maryland enterprise zone may be entitled to an income tax credit for wages paid to newly hired employees in addition to a property tax credit. The local enterprise zone administrator must certify the business to qualify for the credit.

The credits are based on the wages paid during the taxable year to each qualified employee. The business must hire at least one employee who: (1) is a new employee or an employee rehired after being laid off for more than one year; (2) worked for the business for at least 35 hours per week for six months or more; (3) earns at least 150% of the federal minimum wage; (4) spends at least 50% of the workday either in the enterprise zone or on activities of the business resulting from its location in the enterprise zone or focus area; (5) is hired after the date the enterprise zone was created or the date the business located in the enterprise zone or focus area, whichever is later; and (6) is not hired to replace an individual employed by the business within the last four years.

One Maryland Economic Development Credit

Businesses that establish or expand a business facility in a priority funding area (PFA) or as part of a project approved by the Board of Public Works, and are located in a "distressed" Maryland county, may be entitled to a tax credit for costs related to the new or expanded facility. The credit for start-up costs is the lesser of 100% of eligible start-up costs (up to $500,000), less any credits taken in prior years, or $10,000 multiplied by the number of employees that have filled the newly created, qualified positions. The credit for project costs is the lesser of 100% of eligible project costs (up to $5 million), less any credits taken in prior years, or the State income tax liability for the taxable year from the project. An expanded credit is available if the created positions are paid 250% or more of the minimum wage.

Job Creation Tax Credit

Businesses that expand or establish a facility in Maryland resulting in the creation of at least 60 new jobs within a two-year period may be eligible to claim the job creation tax credit. The new jobs must be full-time, permanent, filled, located in Maryland, and pay at least 150% of the federal minimum wage. The threshold is lowered to 30 new jobs if the average salaries of the new jobs are highly paid as determined by a sliding scale relative to the average State salary; and 25 new jobs if the new jobs are created within a State PFA. The value of the credit depends on the number of jobs created, the wages of those jobs in the year the credit was claimed, and whether the jobs were created in a revitalization area. The total credit claimed cannot exceed $1 million for any one business.

Background: The following is a brief discussion on the impact of employment due to the recession, the federal response to the recession, and President Obama's jobs tax credit proposal.

Impact of Recession on Employment

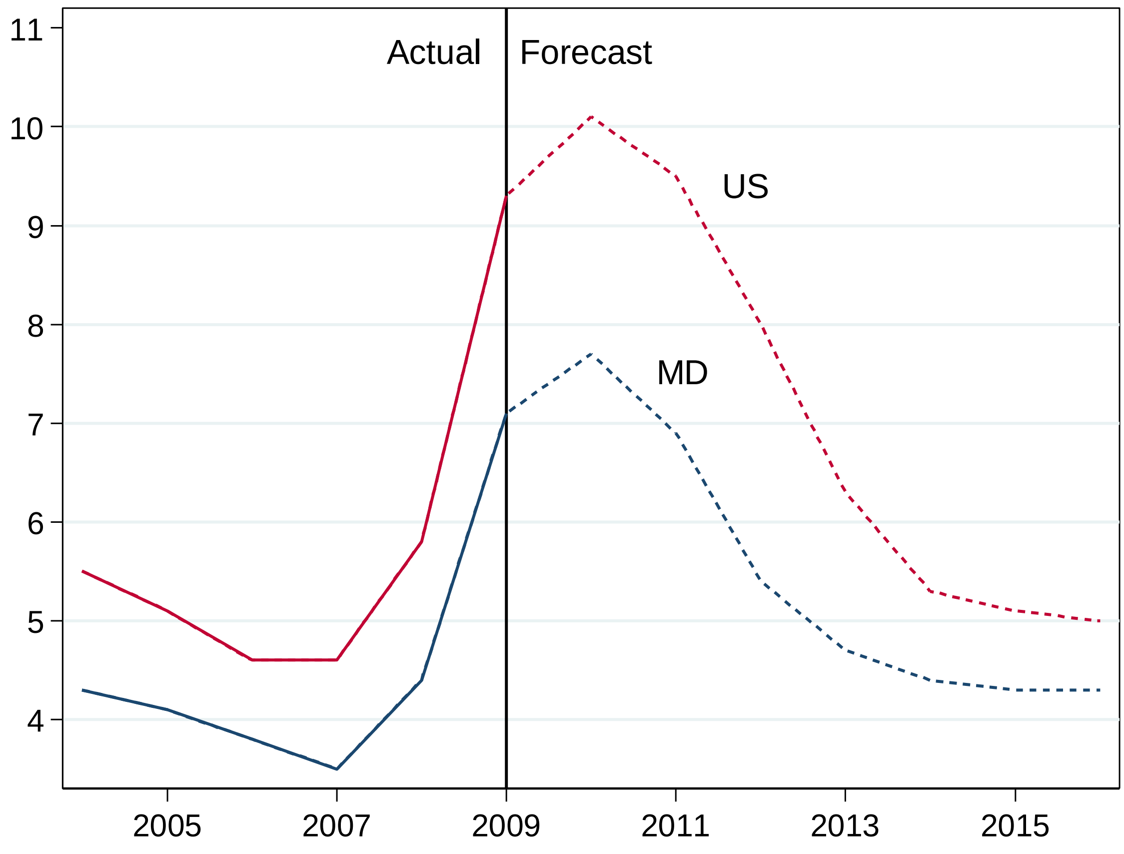
From December 2007 to December 2009, the national unemployment rate increased from 4.9% to 10.0%, and payrolls fell by about 7.3 million. Including the loss of additional jobs that the economy would have created in the absence of the recession, the Congressional Budget Office (CBO) estimates that the recession has lowered employment by about 11 million relative to what it would have otherwise been. Housing and financial market turmoil initially caused job losses in the construction, real estate, and financial activities industries. Although Maryland's economy is less dependent on these industries than other states; real estate, finance and insurance, and construction industry wages comprised about one-fifth of all wages paid in Maryland. As the contagion spread to the rest of the economy, job losses deepened in these sectors and spread to most other industries. Employment in the first half of 2009 contracted by about 75,275 or 3% compared with the first half of 2008 as shown in **Exhibit 1**.

Exhibit 1
Maryland Employment by Industry
2008-2009

Industry	2008	2009	Change	Percent Change
Government	477,229	484,268	7,039	1.5%
Manufacturing	129,213	120,052	-9,161	-7.1%
Construction & Mining	181,309	156,858	-24,451	-13.5%
Trade	387,059	363,772	-23,287	-6.0%
Transportation, Utilities & Warehousing	74,622	71,956	-2,667	-3.6%
Information	50,384	46,571	-3,814	-7.6%
Financial Activities	150,403	143,262	-7,141	-4.7%
Professional & Business Services	397,318	382,775	-14,542	-3.7%
Education & Health Services	365,182	376,757	11,575	3.2%
Leisure & Hospitality	233,066	226,672	-6,394	-2.7%
Other	95,735	93,304	-2,432	-2.5%
Total Employment	**2,541,522**	**2,466,247**	**-75,275**	**-3.00%**

Although the economy expanded in the second half of 2009, likely signaling the worst of the recession is over, most analysts expect a slow recovery. Due to this slow growth and other factors, job growth is expected to be tepid over the next several years and lag behind an overall improving economy. The most recent CBO estimate calculates that national unemployment rates will not approach pre-recession levels until 2014. **Exhibit 2** shows the actual and forecasted unemployment rates for the United States and Maryland for 2004 through 2016.

Exhibit 2
U.S. and Maryland Unemployment Rates
Calendar 2004-2016



Source: CBO, Board of Revenue Estimates, Economy.com

Nationally, unemployment rates in 2009 were significantly higher for men (9.6% compared with 7.4% for women), African Americans (14.8%), Hispanics (12.9%), those with less education, and youths (24.2%).

Maryland is expected to outperform the national economy with unemployment expected to remain about one-quarter lower than the national rate; however, the path of the State's economic recovery and job growth is expected to mirror the national economy. The State's unemployment rate is expected to peak in mid-2010 and not show substantial improvement until 2012. The overall State unemployment rate also masks variations within areas and populations of the State. Seven jurisdictions (Baltimore City, and Caroline, Cecil, Somerset, Washington, Wicomico, and Worcester counties) have unemployment rates of at least 9%.

Unemployment rates understate the amount of individuals that are under- and unemployed, particularly during recessions. Prolonged periods of unemployment increase the number of individuals who are jobless and are not seeking employment. The Bureau of Labor Statistics estimates that including these "marginally attached" individuals and those individuals employed part-time for economic reasons increases the national unemployment rate from 10.0% to 17.3%.

Research has examined the negative impacts of sustained periods of unemployment, including higher poverty rates and lower well being of children. In both the 1981-82 and 1990-1991 recessions, family poverty rates were persistently higher after the recession and were slower to return to pre-recession levels than unemployment rates. In addition to other undesirable consequences, increased poverty rates will likely increase participation in State and federal poverty programs such as the earned income credit and Supplemental Nutritional Assistance Program for many years after the current recession.

Federal Responses to the Recession

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act (ARRA) into law. Together with policies to stabilize the financial system, increase liquidity and credit, and stem foreclosures, ARRA was part of a comprehensive response to the economic downturn that began in fall of 2008. Although the U.S. Congress enacted other legislation, ARRA was the most significant effort to use fiscal policy to boost the economy during the recession. The Council of Economic Advisors (CEA) was charged with providing Congress quarterly reports on the effects of ARRA on overall economic activity, and on employment in particular. In its second quarterly report, CEA provided an assessment of the Act through the fourth quarter of 2009. A total of $263.3 billion of the original $787 billion authorized, or roughly one-third of the total, has been expended or gone to households and businesses in the form of tax reductions. An additional $149.7 billion has been obligated for projects and activities and will generally be disbursed once the projects have been completed. While CEA acknowledged the difficulty of accurately assessing the impact ARRA has had on the economy, it estimated that the Act added between 1.5 to 4 percentage points to each of second, third, and fourth quarter of real gross domestic product (GDP) in 2009. CEA also estimated that as of the fourth quarter of 2009, ARRA increased employment relative to what it otherwise would have been by 1.5 to 2.0 million. Although ARRA is expected to contribute to economic growth for several years, ARRA's impact is expected to peak in mid-2010.

With the economy about 7% below potential GDP, most economists agree that fiscal policy, through cutting taxes and/or increasing public spending, can increase economic output by employing resources that are currently unused. Significant disagreement and uncertainty exists, however, on the effectiveness of fiscal policy in increasing economic output and employment. For example, since the passage of ARRA the trajectory of the unemployment rate has significantly exceeded what was estimated at the time of passage. Analysts disagree over whether this reflects a deterioration of the economy that was worse than expected or whether ARRA has been less effective in stimulating the economy.

Impact of Fiscal Relief Provided to States

Parts of the federal budget and tax system can stimulate the economy during economic downturns without any policy change. Income tax receipts decrease during a recession while outlays such as unemployment insurance increase, mitigating the impact of a recession. These automatic stabilizers are estimated to increase the federal deficit by between $300 to $400 billion annually from federal fiscal 2009 through 2011. The State budget and tax system acts in a similar manner – the recession has decreased State revenues and increased outlays. Unlike the federal government, however, the State is required to have a balanced budget in each year and must cut spending, increase taxes, or take other measures to bring the budget into balance. Large budget deficits caused in part by the recession forced State and local governments to cut spending, raise taxes, and lay off employees; actions which caused additional unemployment and further reduced economic output. A significant portion of ARRA, about $200 billion, provided fiscal relief to states in order to prevent these tax increases and spending reductions. CEA determined that ARRA had provided states with $60 billion in fiscal relief through the end of 2009, and that this relief prevented spending reductions and helped boost employment and economic output.

Obama Jobs Tax Credit Proposal

During the debate on the economic stimulus legislation, President Obama suggested including a $3,000-per-job tax credit, a proposal which the President initially discussed during the presidential campaign. According to published reports, the tax credit was not included in the stimulus bill due to congressional concerns over the ability to effectively design and administer the credit. President Obama resurrected the idea in late 2009 and in January 2010 while in Baltimore publicly outlined a $33 billion two-part tax credit proposal. The first part would offer a flat $5,000 tax credit for each worker hired during 2010. The second part would offer an incremental credit that would provide incentive for firms to expand payrolls (whether by increasing hours, wages, or employment) by reimbursing the Social Security taxes businesses pay on increased payrolls during the year. The tax credit is capped at $500,000, in an effort to maximize small business utilization.

If the credit is enacted and funded at its proposed level, Maryland businesses will likely claim a significant amount of credits. Although the actual amount would depend on the number of eligible businesses in the State increasing employment and wages relative to the rest of the nation, if Maryland businesses claim credits in proportion to the State's share of the national economy, federal job-creation credit claims in Maryland could total $650 million.

CBO recently assessed the ability of a variety of fiscal policies to increase economic growth and employment in 2010 and 2011. This effort included an examination of the effect of creating a tax credit for firms that hire new employees or expand payrolls. CBO concluded that if properly implemented, these tax credits could be an effective way to increase employment in the next couple of years. An incremental job creation tax credit for employers who increase payrolls was estimated to be more effective than a job creation tax credit. **Exhibit 3** shows CBOs estimated impact that several fiscal policies would have on employment (measured in full-time employment equivalents) in 2010, 2010-2011, and 2010-2015.

Exhibit 3
Estimated Policy Impacts on Employment
Full-time Equivalent Employment Per Million Dollars of Budgetary Cost

	Additional FTE Positions		
Policy	**2010**	**2010-2011**	**2010-2015**
Increase Aid to the Unemployed	4-7	8-19	6-15
Job Creation Tax Credit	3-5	5-13	4-11
Incremental Job Creation Tax Credit	5-9	8-18	7-16
Provide Fiscal Relief to States	1	3-7	3-9
Reduce Income Taxes in 2011	<0.5	1-3	1-4

Note: Employment is measured as full-time equivalents. One FTE is equal to one person working full-time for one year
Source: Congressional Budget Office

State Revenues: DLLR is authorized to award a total of $20 million in credits on a first-come, first-served basis for qualified employees hired during 2010. It is estimated that DLLR will award the maximum amount of credits. As a result, general fund revenues decrease by $19.0 million in fiscal 2011. TTF revenues decrease by $1.0 million.

Taxpayers can claim the credit for tax year 2009 (under certain conditions), 2010, and 2011. For each year, the credit can be claimed in an amount equal to $417 for each month the qualified employee is employed. However, if at the time of filing a 2010 tax return the qualified employee is still employed, the employer can claim these months of employment that occur during 2011 on the tax year 2010 return. As a result, it is estimated that all of the credits are claimed on either tax year 2009 or 2010 returns, resulting in all of the revenue loss occurring in fiscal 2011. To the extent that credits are claimed on tax year 2011 returns, revenue losses will occur in fiscal 2012 and will be less than estimated for fiscal 2011.

Indirect Revenue Impacts of the Program

The bill establishes a tax credit for employers who hire eligible individuals during 2010. To the extent the bill increases employment, State revenues could increase as a result of increased income and consumption taxes. In addition, multiplier effects could lead to indirect job creation as individuals who are hired increase their spending, which can lead to an increased demand for additional goods and services.

About 93,000 individuals exhausted unemployment insurance during 2009. In addition, 16,700 individuals received initial unemployment insurance benefits in December 2009 while about 81,000 individuals filed a claim to receive continuing payments. The amount of individuals for which tax credits could be claimed, if eligibility requirements are met, currently totals about 190,700. The bill provides that a maximum of $20 million in credits can be awarded, which translates to 4,000 individuals if the maximum credit is claimed. Accordingly, the credit will have a limited ability to increase employment.

State Expenditures: The Comptroller's Office reports that it will incur a one-time expenditure increase of $37,400 in fiscal 2011 to add the tax credit to the income tax forms. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Local Revenues: Local highway user revenues decrease as a result of tax credits being claimed against the corporate income tax. Local revenues decrease by $305,500 in fiscal 2011.

Small Business Effect: Employers with less than 50 employees were responsible for about 41% of the total U.S. private jobs gains during 2008. Small businesses will benefit by up to $5,000 per eligible employee hired, less any impact the credit has on the taxpayer's federal income tax liability. A significant portion of credits claimed will provide money to businesses that would have otherwise hired individuals, representing a windfall gain to these businesses.

Additional Information

Prior Introductions: None.

Cross File: HB 92 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

Information Source(s): Bureau of Economic Advisors; Bureau of Labor Statistics; Comptroller's Office; Congressional Budget Office; Economy.com; Department of Labor, Licensing, and Regulation; Recovery.gov; U.S. Council of Economic Advisors; Department of Legislative Services

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: *Job Creation and Recovery Tax Credit (JCRTC)*

BILL NUMBER: **SB 106**

PREPARED BY: Alfredo B. Goyburu (Department of Business and Economic Development [DBED], Office of Marketing and Communications)

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

__ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

XX WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

This bill would award Maryland companies a $3,000 tax credit for every qualifying person they hire or have hired between January 1, 2010 and December 31, 2010. A qualifying person would be one that is not working full time and is either currently receiving Maryland Unemployment Insurance Compensation benefits or has exhausted those benefits within the past twelve months. A company could apply the credit to offset tax liability owed to the State. In order to qualify, the filled position must be must be full-time, located in the State, and either newly created or vacant for at least six months. The proposal would cap the aggregate amount of the credit at $250,000 per employer (83 hires) and $20,000,000 total (over 6,000 hires). Credits would be awarded on a first-come first-served basis.

The proposed credit would exert no negative impact upon Maryland, an individual small business, or the small community as a whole. However it could result in Maryland in small businesses receiving a substantial benefit. The tax credit would encourage employers to increase hiring of qualified persons through a state subsidy. The subsidy would partially offset the costs associated with adding a person to a work force.

The proposed credit would exert a beneficial impact upon the small businesses taking advantage of the program. Small businesses average lower wages and salaries than higher-volume employers, meaning that the amount of the benefit would offset a higher share of the costs of having a new worker. The credit would also give small businesses an opportunity to expand their work force, while having the State of Maryland pay the business for some of the risks often associated with hiring persons that have been unemployed for a period of time.