Department of Legislative Services

Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE
Revised

House Bill 173 (The Speaker, *et al.*) (By Request - Administration)
Ways and Means Budget and Taxation

Business and Economic Development - Invest Maryland Program

This Administration bill creates a State-supported venture capital program and also increases funding for the Enterprise Fund and Maryland Small Business Development Financing Authority (MSBDFA) within the Department of Business and Economic Development (DBED). These programs will receive an estimated $70.0 million in total funding from fiscal 2012 through 2014, which is provided through the creation of a tax credit against the insurance premium tax for insurance companies that make qualified contributions to the program. DBED can award a maximum of $100.0 million in tax credits, which can be claimed beginning in tax year 2014. DBED must administer the program, and the bill also provides for the program application and certification process as well as creating a Maryland Venture Fund Authority (MVFA) within DBED.

The bill takes effect July 1, 2011.

Fiscal Summary

State Effect: Enterprise Fund (special fund) revenues increase by $23.3 million annually in FY 2012 through 2014 due to monies received from insurance companies. Enterprise Fund revenues and general fund revenues may increase beginning in FY 2014 due to investment proceeds. General fund revenues decrease beginning in FY 2014 due to decreased insurance premium tax revenues. Enterprise Fund expenditures for qualified investments increase by $23.3 million in FY 2012. Future years reflect estimated distributions from the fund. Special fund expenditures increase by $0.6 million in FY 2012 due to administrative expenses at DBED.

($ in millions)	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
GF Revenue	$0	$0	($10.0)	($20.0)	($20.0)
SF Revenue	$23.3	$23.3	$23.3	-	-
SF Expenditure	$24.0	$24.0	$24.0	$.7	$.8
Net Effect	($.6)	($.7)	($10.7)	($20.7)	($20.8)

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

Local Effect: None.

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:

Program Overview

Under current law, insurance companies pay taxes based on policyholder premiums rather than corporate profits. The Maryland Venture Fund Authority (MVFA) established by the bill will solicit cash (designated capital) from insurance companies through a competitive process overseen by an independent third party. In exchange for the cash received from the insurance companies, DBED will provide insurance companies with tax credits that can be used to offset insurance premium taxes over a five-year period beginning in calendar 2015. The bill authorizes DBED to award a total of $100.0 million in tax credits under the program.

The cash or designated capital received from insurance companies is to be deposited into the Enterprise Fund within DBED in three annual equal installments beginning on June 1, 2012. Of the money deposited in the Enterprise Fund, about 25% will be retained by the fund, 67% will be distributed to eligible private venture firms, about 8% will be distributed to MSBDFA, and $250,000 will be distributed in fiscal 2012 to the Rural Council of Maryland for its operational expenses. The bill states that it is the goal of the State that businesses located in rural areas of the State receive a portion of the investments made by DBED under the program.

An insurance company must request at least $1.0 million in tax credits. The amount of designated capital proposed by insurance companies cannot be less than 70% of the requested amount of tax credits, unless the Secretary of Business and Economic Development determines a higher rate is consistent with current market conditions upon

recommendation of MVFA. If 70 cents in designated capital is contributed for each dollar of insurance premium tax credits:

- a total of $70.0 million in designated capital will be raised, of which $46.9 million will be distributed to eligible private venture firms, $17.1 million to the Enterprise Fund, $5.7 million to MSBDFA, and $0.3 million to the Rural Council of Maryland; and

- insurance companies that participate in the program will receive an annual rate of return from providing designated capital of about 12.2% annually. This also represents the annual cost to the State in reducing future tax revenues in exchange for providing funding to businesses.

The bill provides that the program may receive funding in the State budget if State general fund revenues are greater than expected. If the December 2011 Board of Revenue Estimates' general fund forecast for fiscal 2012 exceeds the amount forecasted in March 2011 by at least $70.0 million, after adjusting for legislation passed in the 2011 session, the bill requires the Governor to submit during the 2012 session a fiscal 2012 deficiency appropriation of up to $70.0 million for the program. The maximum amount of insurance premium tax credits that may be awarded under the bill is required to be reduced based on the amount of any deficiency appropriation, so that the resulting amount of designated capital available for investment under the program is equal to the amount of designated capital that the auction would have otherwise been provided if $100.0 million in credits were awarded.

If qualified investments made under the program are successful, money will be returned to the State. Qualified investments are fully at risk, however, and the State will not receive returns if investments fail. Investment proceeds from MSBDFA and the Enterprise Fund will be retained by DBED. A venture firm that receives designated capital must reimburse the State for 100% of the designated capital provided before the firm can make a nonqualified distribution. However, the bill does not require venture firms to repay the designated capital. Under the bill, any venture firm investment proceeds that exceed the original amount of designated capital and are not otherwise retained by the venture firm will be divided 80% to the general fund and 20% to the venture firm.

DBED Administration

DBED is required to administer the program and must allocate designated capital received under the program and issue tax credit certificates consistent with the bidding process developed by the independent party under contract with MVFA. DBED is also required to:

- enter into a contract with each venture firm receiving designated capital providing for the transfer of the capital;
- secure the commitments of tax credit purchasers;
- submit specified information about designated capital and tax credits to the Maryland Insurance Administration;
- issue venture firm certificates; and
- beginning on January 1, 2013, report annually to the Governor and the Senate Budget and Taxation and House Ways and Means committees specified information about the program.

DBED may (1) purchase insurance or make other financial arrangements to ensure the availability of designated capital committed by tax credit applicants; and (2) adopt regulations to implement the program.

Maryland Venture Fund Authority

The bill establishes a nine-member MVFA within DBED. Members serve four-year terms; seven members are appointed by the Governor with the advice and consent of the Senate, one member is appointed by the Senate President, and one member is appointed by the Speaker of the House. Members of the authority may not receive compensation but are entitled to reimbursement for expenses. The bill requires that (1) certain members have specified experience; (2) members are State residents; (3) members do not have a financial interest in businesses participating in the program; and (4) at least one member is a resident of a rural county in the State.

The authority's responsibilities include providing advice and consulting with DBED on program administration. Subject to the approval of DBED, the authority (1) is required to contract with an independent party to conduct the tax credit bidding process, establish the venture firm application process, and evaluate venture firm applicants; and (2) may enter into written agreements in order to implement the program. The independent third party is required to evaluate the applications submitted by venture firms and recommend to the authority which venture firms should receive designated capital.

On receiving this recommendation, MVFA will select which venture firms receive designated capital and ensure these firms make required investments. In selecting venture firms, MVFA is required to consider (1) the management structure and investment strategy of the venture firm; and (2) the venture firm's commitment to making investments in the State.

Insurance Premium Tax Credits

In order to claim a tax credit against the insurance premium tax as proposed by the bill, an insurance company must be issued a tax credit certificate by DBED and contribute designated capital in three equal installments on June 1 of 2012, 2013, and 2014. An insurance company is either (1) an insurance company that is authorized to do business in the State and has insurance premium tax liability (or other specified State tax liability imposed) as of October 1, 2011; or (2) a holding company that has at least one insurance company subsidiary authorized to do business in the State and contributes designated capital on behalf of authorized subsidiaries.

Under procedures adopted by the independent party selected by MVFA, each tax credit applicant must make a timely and irrevocable offer for at least $1.0 million in tax credits. The amount of designated capital offered may not be less than the greater of 70% of the requested amount of tax credits; or (2) the minimum percentage determined by the Secretary of Business and Economic Development, on recommendation by the independent party under contract with MVFA, consistent with current market conditions. The deadline for tax credit applications is February 1, 2012, and DBED will notify each applicant by May 1, 2012, as to whether it has been approved. The maximum amount of premium tax credits that may be allocated is $100.0 million. The maximum amount of insurance premium tax credits that DBED may award is required to be reduced to the extent the program is funded through a fiscal 2012 deficiency appropriation.

An insurance company may claim credits beginning with tax year 2014 on an insurance premium tax return filed after December 31, 2014. The credit is pro-rated over five years, at up to 20% per year. The credit claimed in each year cannot exceed the insurance premium tax liability imposed in the year; any unused amount may be carried forward to any other tax year. Tax credits may be transferred subject to specified conditions.

An insurance company that provides designated capital and claims tax credits (1) is not required to factor the reduction in tax liability caused by the tax credit for the purposes of policy ratemaking; and (2) is not required to pay any additional taxes as a result of the tax credit.

An insurance company or affiliate may not manage a venture firm, beneficially own more than 15% of the ownership interest of a venture firm, or control venture firm investments.

Designated Capital and Qualified Investments

All funds committed by purchasers of insurance premium tax credits will be deposited into the Enterprise Fund and distributed: (1) 67% to one or more venture firms to make

investments based on the criteria established by the bill; (2) 8% to MSBDFA; and (3) $250,000 to the Rural Maryland Council for its operational expenses. The remaining amount of the total will be retained by the Enterprise Fund. Money provided to the Enterprise Fund is to fund the making of qualified investments to qualified businesses consistent with the existing policies and procedures of the fund. Money provided to MSBDFA is to be invested by the Financing Authority Equity Participation Investment Program in qualified businesses consistent with the existing policies and procedures of the authority.

A qualified investment is the indirect or direct investment by the Enterprise Fund or MSBDFA of cash in a qualified business in exchange for an equity interest, a convertible debt instrument, or an equity participation instrument such as an option or warrant. A qualified investment includes the direct or indirect investment of cash by a venture firm based on the investment criteria established by the bill.

Before a venture firm can make a nonqualified distribution, it must remit to the Comptroller the amount of designated capital it received. After this remittance, any additional proceeds will be split 80% to the Comptroller and 20% to the venture firm. The Comptroller's Office is required to transfer within 30 days to the general fund any monies received under the program. Any designated capital or additional proceeds paid to DBED as a result of MSBDFA and Enterprise Fund investments will be deposited into the Enterprise Fund.

Businesses Eligible to Receive Investments

At the time of the first investment, a business must (1) have its principal business operations in the State; (2) agree to use the investment primarily to establish or support business operations in the State; (3) have no more than 250 employees; and (4) not be primarily engaged in retail sales; real estate development; the business of insurance, banking, or lending; or professional services by accountants, attorneys, or physicians.

A business certified as an eligible business retains eligibility for additional investments under the program if it no longer meets eligibility requirements. These follow-on investments are qualified investments under the program unless the business no longer retains its principal business operations in the State and the investment was made by the Enterprise Fund or MSBDFA.

Venture Capital Firms

In order to receive money under the program, a venture firm must be certified under application procedures adopted by DBED. Venture firms are required to submit an application that includes the applicant's most recent financial statement. Eligibility for

the program is restricted to a venture firm (1) with an equity capitalization, net assets, or written commitments of at least $500,000 in cash or cash equivalents at the time of application; and (2) that has at least two principals or two persons employed with at least five years of money management experience in venture capital or private equity. Venture firms are required to (1) submit specified information to DBED including documentation on the amount of designated capital that is invested; and (2) submit on an annual basis an audited financial statement. Venture firms must apply to DBED by May 1, 2012.

The bill allows venture firms to make qualified distributions for management and operational expenses. A qualified distribution includes the reasonable costs and expenses associated with: (1) organization and syndication, not to exceed a total of $125,000; (2) legal, accounting, and professional services for ongoing operations of up to $50,000 annually; and (3) a yearly management fee of up to 2.5% of designated capital received.

Current Law: No exact tax credit of this type exists, but the State provides several tax credits that reduce the after tax cost of investments made by or in Maryland businesses. These tax credits include:

- the Biotechnology Investment Tax Credit, which allows a tax credit of up to 50% of the amount contributed to a qualified Maryland biotechnology company; and

- the One Maryland Economic Development, Business that Create New Jobs, and Enterprise Zone Tax Credits, which provide tax credits for businesses that make specified capital investments.

In addition to MSBDFA, DBED also administers several business financing programs including the Community Development Block Grant Program; Maryland Economic Adjustment Fund; Maryland Enterprise Fund; Maryland Economic Development Assistance Authority and Fund; Maryland Industrial Development Authority; and Maryland Venture Fund.

Background: Numerous states operate programs to encourage venture capital investments. Certified capital company (CAPCO) programs have been commonly used by states to achieve this goal, beginning in the 1980s with Louisiana's CAPCO program. Under CAPCO programs insurance companies invest in certified capital companies and earn premium tax credits equal to the amount of the insurance company's total debt and equity investment. CAPCOs typically borrow the investment capital from insurance companies to invest in businesses. Although states sacrifice future tax revenues, in theory CAPCO investments in businesses should yield job creation, tax revenues, and increased income to offset the revenue losses.

Several states began to alter CAPCO programs after it was determined that the programs were not achieving their goals in a cost effective manner. In March 2009, the Office of the District of Columbia Auditor audited its CAPCO program. According to the audit, the CAPCO program has fallen short of the desired impact on economic development and that the program was poorly managed. The District's CAPCO program was estimated to cost between $50 million and $76 million and was estimated to create 31 new jobs. The Office of the State Auditor in Colorado examined the state's CAPCO program in October 2003 and identified several problems with the program, including limited capital availability, limited controls over businesses receiving investment capital, and high administrative costs. Following the release of the evaluation, the Colorado General Assembly redirected $100 million in premium tax credits from the CAPCO program to a newly created Venture Capital Program, which operates in a similar manner to the venture firm funding proposed by the bill. Under the Venture Capital Program, Colorado received 86.2 cents of insurance company investments for each dollar in tax credits awarded. A subsequent audit of the program found that the overall program was implemented according to statutory provisions.

Several states have opted to fund venture capital firms through public pension funds instead of using insurance premium tax revenues. The State of Wisconsin Investment Board recently announced plans to invest $80 million in venture capital funds.

Existing Maryland Programs for Business Investments

DBED considers investments the primary tool for business assistance. The agency purchases equity from companies to provide capital for these companies. Investments are made with the hope of an eventual financial return, but the timing and the amount of the return are unknown. The Maryland Venture Fund began in 1994 with the establishment of the Enterprise Fund, which was developed to make equity investments in "new" State enterprises. This initiative was enhanced to target investments in early stage, high technology companies experiencing difficulties attracting private-sector financing. Maryland Venture fund activities are provided through five programs: the Enterprise Investment Fund, the Challenge Investment Program, the Enterprise Venture Capital Limited Partnerships (VCLP) Fund, the Maryland/Israel Development Fund, and the FIPS Certification Grant Program. About 60% of the fund is invested in technology companies and 40% is invested in life science companies. In the fiscal 2010 report on the Maryland Venture Fund, DBED stated that without additional money the fund will have a limited ability to make new investments beyond fiscal 2011 and will primarily monitor existing portfolio companies.

The Enterprise Investment Fund program provides capital through equity purchases for start-up companies that are developing innovative technologies. Investments are limited to 25% of the company's total equity and require a three-to-one outside investor match.

Investments, except those made in venture capital limited liability companies, are generally limited to $500,000 and may not exceed 15 years in duration. A 10-member advisory board provides input for investment recommendations. The program has made investments in 94 ventures through June 30, 2010. A total of $39.2 million in investments have been made since fiscal 1994; DBED has received $62.3 million in returns from these investments through the end of fiscal 2010. The fair market value of the portfolio totaled approximately $14.0 million as of June 30, 2010. DBED projects that in fiscal 2011 and 2012 it will not receive any funds from companies exiting the Enterprise Investment and Challenge Investment Programs and expects the programs to generate $400,000 in income annually through equity investment earnings, royalties, and interest income.

The Challenge Investment Program is a "seed" program to invest in high technology "start-up" firms. The program requires a minimum 1:1 co-investor match. Generally, investment amounts range from $50,000 to $150,000. A total of $11.6 million in investments have been made in 174 high tech companies through June 30, 2010. In the fiscal 2010 Maryland Venture Fund annual report, DBED did not provide information on the program's investment performance since its inception.

The Enterprise VCLP fund has invested $11.3 million in 10 venture capital limited partnerships since fiscal 1994. According to DBED, it recognizes the lack of venture capital participation in deals under $10.0 million and works closely with the venture capital community to connect Maryland based early-stage and technology companies with funding sources. In the fiscal 2010 Maryland Venture Fund annual report, DBED did not provide information on the program's investment performance since its inception. The report did state that the fund has received an annual average of $172,200 in distributions within the last three fiscal years and investments made before 2000 are close to the end of their expected lives and, accordingly, a declining number of distributions of stock/cash to DBED is expected.

MSBDFA

This program provides financing assistance to socially or economically disadvantaged persons in Maryland. Legislation enacted as Chapter 172 of 2001 broadened MSBDFA's scope to reach all businesses unable to obtain adequate, reasonable financing through private lending institutions due to credit criteria. A private contractor reviews the financing applications for presentation to the MSBDFA board. MSBDFA has four programs: Contract Financing Program, Long-term Guaranty Program, Surety Bond Program, and the Equity Participation Investment Program. As of June 30, 2010, the aggregate loan exposure of the program is $32.1 million. During the last five years, MSBDFA incurred net losses of $963,000. In addition, $1.3 million of its loans were nonperforming in fiscal 2010.

TEDCO

The Maryland Technology Development Corporation (TEDCO) recently announced plans to launch its first venture capital fund later this year. TEDCO's goal is to create a pool of money — between $50 million and $100 million — to back early-stage Maryland companies and to make its first investment by January 2012.

State Revenues: Special fund revenues will increase by $23.3 million in fiscal 2012, 2013, and 2014 due to insurance companies providing designated capital as specified by the bill. In addition, general fund and special fund revenues may increase significantly beginning in fiscal 2014 due to proceeds from qualified investments. General fund revenues will decrease beginning in fiscal 2014 due to insurance companies earning tax credits created by the bill. **Exhibit 1** shows the impact of the bill on State revenues in fiscal 2012 through 2019.

To the extent actual fiscal 2012 general fund revenues are greater than the amount forecasted as specified by the bill and the Governor includes a fiscal 2012 deficiency appropriation for the program, revenue losses will be less than estimated. The bill requires that the amount of credits that are available under the program be reduced based on the amount of any deficiency appropriation, so that the resulting amount of designated capital available for investment under the program is equal to the amount of capital that the auction would have otherwise provided if $100.0 million in credits were awarded.

Designated Capital Revenues

In exchange for receiving tax credits, insurance companies are required to provide three equal installments of designated capital on an annual basis beginning on June 1, 2012. It is assumed that the maximum amount of credits is awarded and the amount of designated capital provided by insurance companies is equal to 70% of the total amount of tax credits awarded. Designated capital is to be deposited into the Enterprise Fund within DBED. As a result, Enterprise Fund revenues will increase by $23.3 million annually in fiscal 2012, 2013, and 2014.

Insurance Premium Tax Credits

Insurance premium tax credits can be claimed beginning in tax year 2014 on a tax return filed after December 31, 2014 – these credits can be claimed in calendar 2015 through 2019 at a rate of one-fifth of the total credit earned. In addition to an annual tax return that is filed on March 15 for the preceding calendar year, insurance companies are required to make quarterly tax payments. It is assumed an insurance company will adjust quarterly payments beginning with tax year 2014 in anticipation of claiming the credit on its tax return. As a result, general fund revenues will decrease by $10.0 million in

fiscal 2014, $20.0 million annually in fiscal 2015 through 2018, and by $10.0 million in fiscal 2019. To the extent DBED does not award the maximum amount of credits, revenue losses will be less than estimated. The Maryland Insurance Administration estimates that about 40 licensed insurers are estimated to be eligible to participate in the program, of which a maximum of 8 are Maryland domestic insurers.

Investment Proceeds

Investment proceeds recovered from qualified investments made by the Enterprise Fund and MSBDFA will be used to make additional investments under the program. To the extent venture firms repay designated capital or have proceeds in excess of this amount and elect to make nonqualified distributions, general fund revenues may increase significantly. DBED will receive designated capital on June 1, 2012; it is assumed that any proceeds from the program will be received at the earliest beginning in fiscal 2014. The amount of revenue increase in any year, if any, depends on investment performance and whether venture firms opt to make any nonqualified distributions and cannot be reliably estimated.

State Expenditures:

Designated Capital Distributions

The cash or designated capital received from insurance companies is to be deposited into the Enterprise Fund within DBED. This money will be deposited in three equal installments on an annual basis beginning on June 1, 2012. Of the money deposited in the Enterprise Fund, 67% will be distributed to eligible private venture firms, about 8% will be distributed to MSBDFA, and $250,000 will be distributed to the Rural Council of Maryland. Exhibit 1 shows the distributions to venture firms, MSBDFA, and the council in fiscal 2012, 2013, and 2014. About 25% of designated capital deposited in the Enterprise Fund will be retained by the fund to make qualified investments. It is assumed that DBED distributes all of the money it receives within the same fiscal year, though the actual schedule of investments may differ significantly. Exhibit 1 shows Enterprise Fund distributions based on the bill's required distributions, and total designated capital provided to the fund.

In addition, proceeds generated from Enterprise Fund and MSBDFA investments are required to be reinvested by the programs. Based on the existing history of the programs and current market conditions, any significant proceeds are not expected to occur until at least fiscal 2014. Accordingly, special fund expenditures may increase significantly beginning in fiscal 2014 as a result of DBED making additional investments.

DBED Administrative Expenses

DBED is required to administer the program and select an independent third party to establish the tax credit bidding process and review venture firm applications. DBED indicates it will need to hire two individuals in fiscal 2012 and three individuals in fiscal 2013 to administer the program. Although the bill is effective July 1, 2011, the deadline to apply for tax credits is February 1, 2012. As a result, expenditures increase by $642,815 in fiscal 2012. It includes estimated contracting expenses ($350,000), salaries, fringe benefits, and ongoing operating expenses. Future year expenditures reflect full salaries with 4.4% annual increases and 3% employee turnover; 1% annual increases in ongoing operating expenses, additional positions created in fiscal 2013, and ongoing contracting expenses (estimated at $100,000 annually).

Positions	2
Salaries and Fringe Benefits	$276,611
Equipment	12,195
Contracting Expenses	350,000
Operating Expenses	4,009
Total FY 2012 State Expenditures	**$642,815**

Exhibit 1
HB 173 Fiscal Impact
Fiscal 2012-2019
($ in Millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Revenues								
General Fund								
Insurance Premium Tax Credits	0	0	(10.0)	(20.0)	(20.0)	(20.0)	(20.0)	(10.0)
Investment Proceeds	0	0	-	-	-	-	-	-
Special Fund								
Designated Capital	23.3	23.3	23.3	0	0	0	0	0
Investment Proceeds	0	0	-	-	-	-	-	-
Total Revenues	**23.3**	**23.3**	**13.3**	**(20.0)**	**(20.0)**	**(20.0)**	**(20.0)**	**(10.0)**
Expenditures								
Special Fund								
Designated Capital Distributions								
Venture Firms	15.6	15.6	15.6	0	0	0	0	0
MSBDFA	1.9	1.9	1.9	-	-	-	-	-
Enterprise Fund	5.6	5.8	5.8	-	-	-	-	-
Rural Council of Maryland	0.3	0	0	0	0	0	0	0
Total Distributions	23.3	23.3	23.3	-	-	-	-	-
DBED Administrative Expenses	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.9
Total Expenditures	**24.0**	**24.0**	**24.0**	**0.7**	**0.8**	**0.8**	**0.8**	**0.9**
Net Effect	**(0.6)**	**(0.7)**	**(10.7)**	**(20.7)**	**(20.8)**	**(20.8)**	**(20.8)**	**(10.9)**

Additional Information

Prior Introductions: None.

Cross File: SB 180 (The President, *et al.*) (By Request - Administration) - Budget and Taxation.

Information Source(s): Department of Business and Economic Development, Maryland Insurance Administration, Office of the District of Columbia Auditor, State of Colorado Office of the State Auditor, *Governing*, Department of Legislative Services

Fiscal Note History: First Reader - February 15, 2011
ncs/jrb Revised - House Third Reader - April 8, 2011
Revised - Enrolled Bill - May 13, 2011

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES (SFY 2011)

TITLE OF BILL: *InvestMaryland*

BILL NUMBER: **SB 180/ HB 173**

PREPARED BY: Alfredo B. Goyburu (Department of Business and Economic Development, Economic, 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

As described below, DBED estimates that this legislative proposal would confer a direct benefit upon 200 to 400 small businesses over a five year period. Businesses that would not observe a direct benefit would observe neither an additional burden, nor direct benefit as a result of this proposal. However businesses that would observe a direct benefit would observe a significant impact.

This bill would create a tax credit that Maryland-based insurance companies could purchase through a competitive bidding process. Funds raised through this process would be invested in Maryland-based companies through the Maryland Venture Fund (the "Fund") and designated third-party venture capital firms. The Fund is a seed and early-stage equity fund that normally receives annual General Fund or Special Fund appropriations. The Fund makes direct investments in small start-up firms involved in the technological or life sciences fields.

DBED estimates indicate that the issuance of an aggregate $145 million in tax credits would raise approximately $100 million from Maryland-based insurance companies. These funds would be split equally between the Maryland Venture Fund and the designated third-party venture capital firms. This funding could be matched by private equity firms contributing follow-on capital in amounts ranging between five and ten times the funding raised. Under the bill, the cash investments would be made in three annual installments from 2012 – 2014, but participating insurance companies would not be able to begin to claim their tax credits until 2015. Each year from 2015 through 2019 they would be able to claim up to 20% of their total tax credit. As a result, the timing between the investment of funds and the claiming of the tax credit would be staggered. This would allow the State to spread the cost of tax credit claims over the five-year period from 2015-2019.

The Fund traditionally invests between $150,000 and $500,000 per transaction, provided additional private investors commit to a match of 3:1 or higher. These investments can play a vital role in helping a firm evolve from its initial stages of development into a viable business.

During the past four years, the legislature has not appropriated new General Funds for the Venture Fund. As a result, investment volume has declined significantly from $4 million in SFY 2008 to $1.4 million in SFY 2011. The proposal would enable the state indirectly to inject cash into the Fund, thus allowing the Fund to increase its volume of investments while spreading out associated costs over future years.

DBED estimates that about 40 to 80 small businesses per year would receive either Maryland Venture Fund investment or third-party venture capital investment as a result of the proposed legislation. DBED also estimates that the proposal would exert an impact over a five year period. Therefore the proposed legislation would confer a positive impact upon 200 to 400 Maryland-based small businesses engaged in categories of economic activity vital to the state's economic performance.

Firms requiring venture capital tend to be either small, in the early to intermediate stages of their corporate development or both. They are not necessarily newly founded. In particular purely private venture capital companies favor firms that:

- are marketing a promising new technology, marketing idea or product application,
- have or are close to establishing patent protection for their idea (if applicable),
- have not issued an initial public offering, but show promise of being able to so within a few years.