

Department of Legislative Services
 Maryland General Assembly
 2012 Session

FISCAL AND POLICY NOTE

House Bill 943 (Delegate Barve)
 Ways and Means

Income Tax Credit - Qualified Research and Development Expenses - Small Business Refund

This bill expands the existing research and development (R&D) tax credit by increasing to \$18 million the aggregate amount of credits that the Department of Business and Economic Development (DBED) can approve in each calendar year. The bill also allows the credit to be refundable if the business claiming the credit meets specified criteria.

The bill takes effect June 1, 2012, and applies to all R&D tax credits certified after December 15, 2012.

Fiscal Summary

State Effect: General fund revenues decrease by \$4.9 million in FY 2014 as a result of additional tax credits being claimed against the corporate income tax, with losses increasing to \$8.7 million by FY 2017. Transportation Trust Fund (TTF) revenues decrease by \$1.0 million and Higher Education Investment Fund (HEIF) revenues decrease by \$0.4 million in FY 2014. Future year revenue estimates reflect carry forwards from previous years, expansion of the credit, and the current corporate income tax forecast. Expenditures are not affected.

(\$ in millions)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	\$0	(\$4.9)	(\$6.7)	(\$8.5)	(\$8.7)
SF Revenue	\$0	(\$1.4)	(\$2.0)	(\$2.5)	(\$2.3)
Expenditure	0	0	0	0	0
Net Effect	\$0	(\$6.3)	(\$8.7)	(\$11.0)	(\$11.0)

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

Local Effect: Local highway user revenues distributed from the corporate income tax decrease by \$0.1 million in FY 2014 and by \$0.2 million in FY 2017. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill expands the existing R&D tax credit by increasing to \$18 million the aggregate amount of credits that DBED can approve in each calendar year. The amount of basic credits that can be awarded annually is increased from \$3.0 million to \$9.0 million and the amount of growth credits that can be awarded is also increased from \$3.0 million to \$9.0 million.

The bill allows the credit to be refundable if the business claiming the credit is a for-profit corporation, limited liability company, partnership, or sole proprietorship that at the beginning or end of the taxable year in which the eligible R&D expenses are incurred, has net book value assets totaling less than \$5 million.

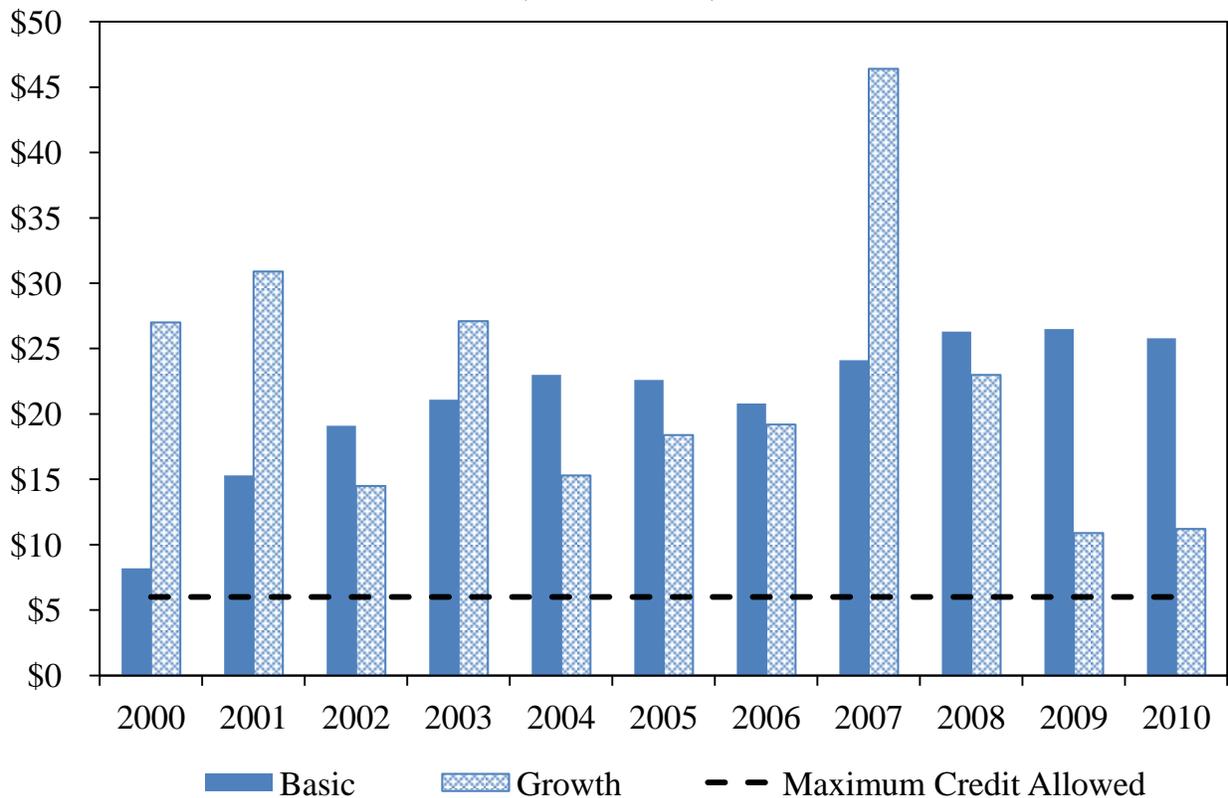
The bill applies to all tax credits certified after December 15, 2012.

Current Law: Chapters 515 and 516 of 2000 established the Maryland Research and Development Tax Credit. Companies that incur qualified research and development expenses in Maryland are entitled to the credit. The total credits approved may not exceed \$6 million each year. There are two types of credits available to businesses: (1) a basic credit equal to 3% of the Maryland qualified research and development expenses paid during the tax year, up to the Maryland base amount; and (2) a growth credit equal to 10% of the Maryland qualified research and development expenses paid during the year that exceed the Maryland base amount. Research and development expenses are typically counted as a business expense and are deducted from State tax liability. Businesses claiming the credit are required to add back to Maryland adjusted gross income the amount of credits claimed. The R&D credit is currently scheduled to terminate on June 30, 2021.

Background: Exhibit 1 lists the amount of qualifying R&D credits applied for and the amount of credits allowed due to the credit cap since the inception of the credit. In every year the amount of credits sought has substantially exceeded the \$6.0 million annual cap. When oversubscribed, the amount approved for each credit is reduced by a proportional amount. For example, in tax year 2005 DBED reduced the amount of credit a business qualified for by 85%.

The number of companies claiming the credit has increased substantially since the credit was established while the annual amount of credits available has not changed. As a result of oversubscription and the resulting reduction in the value of the credit, the credit provides a limited direct incentive for companies to increase research and development activities. In tax year 2007, the basic credit was equal to 0.37% of eligible expenses compared with a statutory rate of 3% while the growth credit rate was reduced from 10% to 0.65%. In addition, the deductibility of State and local taxes paid for federal income tax purposes, the requirement that companies claiming the credit add back the amount of credit claimed, and carry forwards further dilute the amount of the incentive provided. For example, the Department of Legislative Services (DLS) estimates that the incentive provided by the basic credit translates to a company receiving \$1,938 for conducting an additional \$1.0 million in qualified research and development activities.

Exhibit 1
R&D Credits Applied for and Allowed
By Tax Year
(\$ in Millions)



Although the credit provides very little direct incentive for companies to increase research and development activities, the credit decreases tax burdens for high-tech companies relative to other companies in the State. Lower taxes for these companies can both help spur growth for these companies and assist in the State's ability to attract and retain these companies.

DBED awarded a total of \$54 million in credits to 284 companies between tax year 2000 and 2008. Use of the credit has been dominated by a few large corporations. A little more than one-half of all credits (\$28.5 million) have been awarded to 10 companies. Credits were awarded most to companies in the following sectors: pharmaceutical and medicine manufacturers (38%); bioscience (14%); computers (12%); and aerospace/defense (11%). DLS estimates that a little over half of the companies that were awarded credits in tax year 2005 were headquartered in Maryland – these companies were awarded approximately 37% of all credits.

State Revenues: The bill expands the research and development tax credit by increasing to \$18 million the aggregate amount of credits that DBED can approve in each calendar year and by making the credit refundable for companies who meet specified criteria. To the extent that credits are claimed sooner than estimated, revenue losses will occur earlier than estimated.

Although the extension is effective in calendar 2012, before claiming the tax credit DBED must certify the amount of research and development expenses. DBED certifies expenses on December 15 of the calendar year following the end of the taxable year in which the qualifying expenses occurred. A business must then file an amended return to claim the credit – it is assumed that the earliest this could be done is in fiscal 2014 and that companies do not adjust estimated payments. To the extent that companies adjust estimated payments in anticipation of earning credits, revenue losses would occur in fiscal 2013.

The estimated revenue loss due to the expansion and refundability of the tax credit is based on the following facts and assumptions:

- the full \$18.0 million in credits will be awarded in each tax year;
- 100% of credits are claimed against the corporate income tax;
- according to the Comptroller's Office, from tax year 2000 through 2006 about one-half of the credits earned in each year was claimed in that tax year;
- one-quarter of credits will be claimed in the tax year after the credit was earned and another one-quarter of credits will be claimed in the third tax year after the credit was earned;

- any credit claimed is added back to federal adjusted gross income, resulting in additional tax liabilities of 8.25% on the amount of the credit; and
- 10% of all credits claimed will be refundable.

It is assumed that the provision of the bill making the credit refundable for certain businesses will only impact tax credits claimed for tax year 2012 and later. To the extent DBED certifies tax credits after this date for previous tax years, revenue losses will be greater than estimated.

Local Revenues: Local highway user revenues will decrease as a result of credits claimed against the corporate income tax. Local highway user revenues will decrease by \$100,000 in fiscal 2014, \$138,000 in fiscal 2015, \$175,000 in fiscal 2016, and \$154,000 in fiscal 2017.

Additional Information

Prior Introductions: None.

Cross File: SB 570 (Senator King, *et al.*) - Budget and Taxation.

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

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mlm/jrb

Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510