

Department of Legislative Services
 Maryland General Assembly
 2013 Session

FISCAL AND POLICY NOTE
Revised

House Bill 803

(Chair, Ways and Means Committee)(By Request -
 Departmental - Business and Economic Development)

Ways and Means

Budget and Taxation

**Income Tax - Business and Economic Development - Cybersecurity Investment
 Incentive Tax Credit**

This departmental bill creates a tax credit against the State income tax for qualified investments in Maryland cybersecurity companies. The refundable credit is equal to 33% of the qualified investment, not to exceed \$250,000; and is to be claimed by the Maryland cybersecurity companies. The amount of credits that the Department of Business and Economic Development (DBED) can award each year cannot exceed the amount of money appropriated to a reserve fund established by the bill.

The bill takes effect July 1, 2013, and applies to tax year 2014 through 2018. The bill terminates June 30, 2019.

Fiscal Summary

State Effect: General fund expenditures increase by \$3.1 million in FY 2014, which reflects the appropriation to the tax credit reserve fund and one-time implementation costs at the Comptroller’s Office. Transportation Trust Fund (TTF) and Higher Education Investment Fund (HEIF) revenues may decrease beginning in FY 2015. The FY 2014 budget includes a general fund expenditure increase of \$3.0 million in FY 2014 due to the credit. **This bill establishes a mandated appropriation.**

(\$ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
SF Revenue	\$0	(-)	(-)	(-)	(-)
GF Expenditure	\$3.1	\$2.0	\$2.0	\$2.0	\$2.0
Net Effect	(\$3.1)	(\$2.0)	(\$2.0)	(\$2.0)	(\$2.0)

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

Local Effect: Local highway user revenues distributed from TTF will decrease as a result of credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: DBED has determined that this bill has minimal or no impact on small businesses (attached). The Department of Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary: The bill establishes a Maryland cybersecurity Investment Tax Credit Reserve Fund. The total amount of tax credit certificates issued by DBED in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. The bill requires the Governor to appropriate at least \$2.0 million to the reserve fund in each year. Any amount of money in the fund that is not expended in the fiscal year is rolled over into the next fiscal year. DBED may also use money appropriated to the reserve fund to pay for the costs of administering the tax credit.

The credit is claimed by a qualified Maryland Cybersecurity company (QMCC) which (1) meets the qualifications of the bill; (2) follows the application certification process established by the bill; and (3) receives an investment from a qualified investor. A QMCC can claim a refundable credit equal to 33% of the investment, not to exceed \$250,000. DBED may not certify investments in a single cybersecurity company that total more than 15% of the total appropriations to the reserve fund for that fiscal year. An eligible investment is defined as an at-risk investment of at least \$25,000 in exchange for stock or ownership interest. An investor may not acquire an ownership interest in a company that exceeds 25% and must submit an application to DBED.

A qualifying company is defined as a for-profit entity that is primarily engaged in the development of innovative and proprietary cybersecurity technology and meets specified criteria including requirements that the company (1) has been in business for no more than five years; (2) has less than 50 full-time employees; (3) has its headquarters and base of operations in Maryland; (4) is not publicly traded on any exchange; (5) has not participated in the tax credit program for more than one prior fiscal year; (6) owns or has properly licensed any proprietary technology; and (7) has an aggregate capitalization of at least \$100,000.

Tax credit applications are approved on a first-come, first-served basis until the total cap for the year is reached. The bill provides for the circumstances under which the credit may be rescinded, revoked, or recaptured.

DBED is required to (1) approve tax credit applications; (2) determine the eligibility of QMCCs and investors; and (3) adopt regulations in consultation with the Comptroller to implement the credit. DBED may establish a panel of experts in the area of cybersecurity technology to assist DBED in determining when a company is a QMCC.

Current Law/Background: No tax credit exists for investments in cybersecurity companies. Chapter 99 of 2005 (HB 664) established the biotechnology investment tax credit, which offers a similar tax credit for investments in qualified biotechnology companies.

Background:

Commission on Maryland Cybersecurity Innovation and Excellence

Chapters 250 and 251 of 2011 (SB 557/HB 665) established the Commission on Maryland Cybersecurity Innovation and Excellence to (1) review current federal and State laws, standards, and policies for inconsistencies and preemption issues; (2) provide recommendations regarding strategic plans to promote cybersecurity innovation and recover from attacks on cybersecurity; and (3) recommend methods of promoting innovation through public-private partnerships, the education system, research and development, and selection of a State agency suitable to implement a pilot program. The commission is required to submit its final findings and recommendations to the Governor and the General Assembly by September 1, 2014.

Maryland Cybersecurity Industry

According to DBED, the State's cybersecurity industry includes both private companies and federal government agencies engaged in cybersecurity activities, including the National Security Agency, the U.S. Cyber Command, the National Institute of Standards and Technology, Defense Information Systems Agency, Intelligence Advanced Research Projects Activity, and numerous defense contractors. A recent study indicated that the State had 19,413 cybersecurity job openings, with more than 13,000 openings in Baltimore City. Efforts to bolster the cybersecurity industry in Maryland include CyberMaryland, a public/private partnership providing resources and services for cybersecurity companies.

State Fiscal Effect:

Appropriations to the Reserve Fund

The fiscal 2014 budget includes a general fund appropriation of \$3.0 million for the tax credit program.

The Governor is required to appropriate at least \$2.0 million to the reserve fund in each year. Assuming the program is funded at this minimum level, general fund expenditures

will increase by \$2.0 million annually beginning in fiscal 2015. However, there is no limit on the amount that can be appropriated to the reserve fund. To the extent that the Governor provides more money to the reserve fund in any year, the increase in general fund expenditures will be greater.

Administrative Expenses

DBED reports that it can administer the tax credit with existing budgeted resources. In addition, the bill authorizes DBED to use money appropriated to the reserve fund to pay for its administrative costs.

The Comptroller's Office reports that it will incur a one-time expenditure increase of \$103,400 in fiscal 2014 to add the credit to the personal and corporate income tax forms. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Revenue Impacts

Within 15 days after the end of each fiscal year, DBED is required to notify the Comptroller of the total amount of credit certificates that were issued during the fiscal year. Upon this notification, the Comptroller is required to transfer from the reserve fund to the general fund the total amounts stated in the credit certificates that were issued during the fiscal year. A portion of corporate income tax revenues are distributed to TTF and HEIF. As a result, general fund revenues may increase while TTF and HEIF revenues may decrease.

For illustrative purposes only, if one-half of the \$3.0 million in credits awarded in fiscal 2014 is claimed against the corporate income tax and the other half is claimed against the personal income tax, TTF revenues will decrease by \$248,300, and HEIF revenues will decrease by \$90,000, and as a result the credit will have a net general fund impact of \$2.7 million.

Additional Information

Prior Introductions: None.

Cross File: None.

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

Fiscal Note History: First Reader - February 21, 2013
ns/jrb Revised - House Third Reader - April 1, 2013
Revised - Enrolled Bill - May 16, 2013

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Business and Economic Development – Cybersecurity Investment Incentive Tax Credit

BILL NUMBER: HB 803

PREPARED BY: Department of Business and Economic Development

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

This proposal would create a Cybersecurity Investment Incentive Tax Credit similar to the existing Biotechnology Investment Incentive Tax Credit. This tax credit provides an incentive to investors (individuals and businesses) that invest up to \$500,000 in early stage cyber firms primarily engaged developing products for commercial and federal markets. Funded at \$6 million annually, the program would provide startup investment to 12-15 companies per year.

The legislative proposal would not exert a significant impact upon a significant share of Maryland-based small business. It would not impose a burden or confer a benefit upon most Maryland-based small business. **However, all of the companies to receive investment through this program would be Maryland-based small businesses.** According to 2011 Quarterly Census of Employment and Wages (BLS) Maryland had 7,261 computer systems designs employers with 64,800 employees. That is an average of fewer than nine employees per company. According to the Census Bureau's County Business Patterns for 2010, over 93% of Maryland Computer Systems Design establishments have fewer than 50 employees.