

Department of Legislative Services
Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE
Revised

House Bill 742
Ways and Means

(Delegate Walker, *et al.*)

Budget and Taxation

Regional Institution Strategic Enterprise Zone Program

This bill establishes the Regional Institution Strategic Enterprise (RISE) Zone Program, to be administered by the Department of Business and Economic Development (DBED). The purpose of the RISE Zone program is to access institutional assets that have a strong and demonstrated history of commitment to economic development and revitalization in the communities in which they are located. A qualified institution may apply with a county, municipal corporation, or the economic development agency of a county or municipal corporation to DBED for designation of an area as a RISE zone. A business entity that locates in a RISE zone is entitled to a property tax credit, an income tax credit, and priority consideration for assistance from the State's economic development and financial assistance programs.

A qualified institution may apply to designate an area as a RISE zone beginning July 1, 2015. The bill takes effect June 1, 2014.

Fiscal Summary

State Effect: State revenues may decrease significantly due to income tax credits claimed against the income tax. General fund expenditures increase by \$347,200 in FY 2016 due to implementation costs. General fund expenditures may decrease beginning in FY 2017 due to a reduction in State Enterprise Zone property tax credit reimbursements.

Local Effect: Property tax revenues in counties and municipalities in which a RISE zone is designated may decrease significantly as a result of the bill. Local income tax revenues and local highway user revenues will decrease due to income tax credits claimed against the income tax. Indeterminate impact on local revenues and debt service expenditures related to tax increment financing bonds. Local expenditures may increase minimally to administer the program.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The RISE zone program provides income and property tax credits to qualifying businesses within a geographic area designated as a RISE zone by DBED. Entities that are approved by DBED as a qualified institution may submit a joint application with a county, municipal corporation, or an applicable economic development agency for an area to be designated as a RISE zone as described below. The Secretary of Business and Economic Development must adopt regulations on evaluating qualified institution applications and may establish other requirements by regulations for designation as either a RISE zone or a qualified institution. Before adopting regulations implementing the program, DBED is required to organize a group of interested parties, stakeholders, and community development experts in order to receive advice on the proposed regulations.

Qualified Institutions

A qualified institution includes (1) an institution of higher education (public and private four-year institutions and community colleges); (2) a nonprofit organization that is affiliated with a federal agency; or (3) a regional higher education center.

The Secretary of Business and Economic Development may designate an institution as a qualified institution if the institution:

- has evidence of an intention to (1) make a significant financial investment or commitment; (2) use the resources and expertise of the institution to spur economic development and community revitalization; and (3) create a significant number of new jobs in an area that is proposed to become a RISE zone;
- has demonstrated a history of community involvement and economic development within the communities that the institution serves; and
- meets the minimum financial qualifications established by the Secretary of Business and Economic Development.

The Secretary of Business and Economic Development must (1) approve or reject an application for designation of a qualified institution within 90 days of submission of an application, and (2) notify the Legislative Policy Committee at least 30 days before approval or rejection of an application, so that the committee may provide advice to the Secretary.

RISE Zone Designations

A qualified institution may apply to the Secretary of Business and Economic Development to designate an area as a RISE zone beginning July 1, 2015, and the application must contain specified information. The application must be made jointly with a county, municipal corporation, or applicable economic development agency. The Secretary of Business and Economic Development must (1) approve or reject an application for designation of a RISE zone and define the zone boundaries within 120 days of submission of an application, and (2) notify the Legislative Policy Committee at least 45 days before approval or rejection of an application, so that the committee may provide advice to the Secretary. The Secretary may not (1) approve more than three zones in a county or municipal corporation; and (2) designate a RISE zone within a development district or special taxing district. The designation of a zone may not be construed to limit or supersede land use policies adopted by a county, municipal corporation, or applicable bi-county agency.

RISE zones must be located in the immediate proximity to a qualified institution unless (1) the proposed zone is located within a rural part of the State; and (2) an appropriate nexus for the increased economic and community development is established with the qualified institution.

RISE zone designations are effective for five years, DBED may extend this designation for an additional five years if the qualified institution applies jointly with a county, municipal corporation, or applicable economic development agency.

The Secretary of Business and Economic Development must assign a business and community development concierge, who is an employee of DBED, to a RISE zone to assist entities locating in the RISE zone with State or local permit and license applications, accessing existing programs at DBED; the Department of Housing and Community Development; the Maryland Department of Transportation; the Department of Labor, Licensing, and Regulation; or the Maryland Technology Development Corporation and any other authorized activities relating to the development of the RISE zone.

A business may qualify for (1) a property tax credit; (2) an income tax credit; and (3) priority consideration for assistance from DBED financial assistance programs. These programs include the Maryland Economic Adjustment Fund (MEAF), Maryland Economic Development Assistance Authority and Fund (MEDAAF), Maryland Industrial Development Financing Authority (MIDFA), and the Maryland Small Business Development Financing Authority (MSBDF).

Tax credits may be awarded to a business entity that (1) moves into or locates in a RISE zone on or after the date that the zone is designated or (2) is located within the zone prior to designation if the business entity makes a significant capital investment or expansion of its labor force after a RISE zone is designated. DBED must adopt regulations establishing criteria to determine significant capital investments or expansion of its labor force. A business may not qualify for tax credits unless DBED, in consultation with the county or municipal corporation in which the zone is located, certifies that the business and its location is consistent with the target strategy of the zone.

Property Tax Credit

A local government must grant a property tax credit against local real property taxes imposed on the eligible assessment of qualified property owned by a business entity. A business entity is a person who operates or conducts a trade or business, and it includes a person who operates, develops, constructs, or rehabilitates real property if the real property is intended for use primarily as single or multifamily residential property and is partially devoted to a nonresidential use. Qualified property is real property that is not used for residential purposes, used in a trade or business by a business entity, and located in a RISE zone. State property taxes imposed on real property are not affected.

The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property improvements, which is calculated by the State Department of Assessments and Taxation (SDAT). Enhanced credits are granted if the property is located within a State enterprise zone or focus area within an enterprise zone.

As shown in **Exhibit 1**, the credit is applied to the tax imposed on 50% of the eligible assessment during the first year, and 10% in the second through fifth year. For qualified property within an enterprise zone, a business can receive the 80% credit for the five-year period, and for qualified property within a focus area of an enterprise zone, a business can receive a 100% credit for the five-year period.

If the RISE zone in which the business is located is renewed by DBED, a business may claim an additional property tax credit equal to 10% of the eligible assessment in years 6 through 10.

Exhibit 1
RISE Zone Property Tax Credit
Percentage of Eligible Property Assessment

<u>Taxable Year</u>	<u>Percentage</u>
1	50%
2-5	10%
6-10*	10%

*Business may receive a credit of 10% in years 6-10 only if the zone is re-designated by DBED.

Source: Department of Legislative Services

The governing body of a county or municipal corporation may increase by local law the value of the credit shown in Exhibit 1.

If the designation of a RISE zone expires, the property tax credit continues to be available to a qualified property.

The Secretary of Business and Economic Development must certify to SDAT that the properties are qualified properties for each taxable year for which the property tax credit is to be granted and the date that the real properties became qualified properties. SDAT must submit to DBED specified information regarding the qualified properties. Local governments are required to grant the property tax credits and calculate the value of the credit each year. The bill also clarifies that RISE zone property tax credits do not impact State reimbursements for enterprise zone property tax credits.

Income Tax Incentives

A qualified business entity within a RISE zone may claim enterprise zone income tax credits. **Exhibit 2** shows the value of these income tax credits.

Exhibit 2
Enterprise Zone and Focus Area
Income Tax Credit

Enterprise Zone

Regular employee	\$1,000 per employee (one-time)
Economically disadvantaged employee	\$6,000 per employee (over three years)

Focus Area

Regular employee	\$1,500 per employee (one-time)
Economically disadvantaged employee	\$9,000 per employee (over three years)

Source: Department of Business and Economic Development

DBED and the Comptroller must assess the effectiveness of the tax credits and report specified information about the program by December 15 of each year to the Governor and the General Assembly. The Comptroller must report by January 1, 2017, on the cost and impact of the income tax credit and potential cost and impact of providing an income tax depreciation incentive for RISE zone businesses.

Tax Increment Financing

The bill extends the authority of counties and Baltimore City to issue bonds supported by tax increment financing (TIF) or other similar financing instruments in order to finance certain costs within a RISE zone. A special fund may be created by a local government to facilitate infrastructure improvements within a RISE zone. In addition to the uses for TIF bond proceeds authorized under current law, the bill authorizes their use in RISE zones for (1) historic preservation or rehabilitation; (2) environmental remediation, demolition, and site preparation; (3) parking lots, facilities, or structures of any type whether for public or private use; (4) schools; (5) affordable or mixed-income housing; (6) stormwater management and storm drain facilities; (7) innovation centers and laboratory facilities or structures of any type, whether for public or private use, including maintenance and installation of improvements in the structures and services that support the purposes of the RISE zone program; and (8) any other facilities or structures of any type whether for public or private use that support the purposes of the RISE zone.

Current Law:

Enterprise Zone Property Tax Credit

Businesses located or locating in an enterprise zone may receive a 10-year property tax credit against local real property taxes. The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property

improvements. The credit is applied to the tax imposed on 80% of the eligible assessment during the first five years, and decreases by 10% annually to 30% in the final year. Within a focus area, a business can receive the 80% credit for the full 10-year period. In addition, businesses in a focus area may be eligible for a 10-year, 80% tax credit against local personal property taxes on new investment. During the course of the property tax credit period, SDAT is responsible for reimbursing local governments (through the department's annual general fund budget) for 50% of the property tax revenue lost as a result of the credit.

In order to obtain the property tax credit, a business located within a designated enterprise zone must contact the local enterprise zone administrator to determine whether a particular property meets specific requirements within a given enterprise zone. While State law indicates that businesses may qualify for the credit by making capital improvements or hiring new employees, local enterprise zones may establish additional requirements (*e.g.*, qualifying businesses must hire a certain number of new employees or that the jobs created must be in certain industries). Following a determination by the local administrator that a property qualifies for the credit, the administrator certifies this finding in writing to SDAT. SDAT will then calculate the amount of the assessment that is eligible to receive the credit. In addition to computing the amount of the eligible property assessment, SDAT is required to keep track of each property that has been certified by the local enterprise zone administrator and notify each local jurisdiction of its property tax credit obligation. It should be noted that the credit is granted to the owner of the qualifying property. In cases where a lessee makes the capital improvements, the lessee is responsible for executing an agreement with the owner of the property regarding the receipt of the property tax credit.

Enterprise Zone Income Tax Credit

There are two types of income tax credits for firms located within an enterprise zone: a general income tax credit and a larger income tax credit for hiring economically disadvantaged employees. As shown in Exhibit 2, the general income tax credit is a one-time \$1,000 credit per new employee filling a newly created position, or \$1,500 for each qualified new employee in a focus area. For economically disadvantaged employees, the credit increases to a total of \$6,000 per new employee, or \$9,000 per new employee in a focus area. The tax credit for economically disadvantaged employees is claimed over a three-year period.

Similar to the property tax credit, businesses located in an enterprise zone must be certified by the local enterprise zone administrator in order to be eligible to receive the income tax credit (including the focus area credit). To qualify for the credit, businesses must hire at least one employee who (1) is hired after the business was located in the enterprise zone or after the enterprise zone was designated; (2) is employed by the

business for at least 35 hours per week for 6 months (or 12 months in a focus area) before or during the taxable year in which the credit is taken; (3) spends at least 50% of the workday either in the enterprise zone or on an activity related to the enterprise zone; (4) is hired to fill a new position (*i.e.*, the firm's number of new full-time positions must increase by the number of credits taken); and (5) earns at least 150% of the federal minimum wage. Businesses claiming the credit for hiring an economically disadvantaged employee must obtain certification from the Department of Labor, Licensing, and Regulation (DLLR). Once certified, a business may claim the income tax credit.

DBED Business Financing Assistance

The 1997 Priority Funding Areas Act directs State funding for growth-related infrastructure to priority funding areas (PFAs), providing a geographic focus for State investment in growth. PFAs are existing communities and places where local governments want State funding for future growth. Growth-related projects include most State programs that encourage growth and development such as highways, sewer and water construction, economic development assistance, and State leases or construction of new office facilities.

Tax Increment Financing

All counties and municipalities are authorized to utilize tax increment financing under Title 12, Subtitle 2 of the Economic Development Article (the Tax Increment Financing Act). In Baltimore City, the authority to use tax increment financing is provided in the city charter. Before issuing bonds, a governing body must either designate a contiguous special taxing district or identify an area that has been designated as a sustainable community.

Background:

Enterprise Zone Tax Credit Program

The Enterprise Zone tax credit program, established in 1982, is intended to encourage economic growth within economically distressed areas of the State and to increase employment of the chronically unemployed. As of September 2013, there are 30 enterprise zones in 12 counties and Baltimore City. The Secretary of Business and Economic Development may only designate an area as an enterprise zone if it is in a priority funding area and satisfies at least one criterion related to economic distress.

The State reimburses local governments for one-half of the cost of the enterprise zone property tax credit. From fiscal 2001 to 2014, State reimbursements to local governments totaled \$131.2 million. In fiscal 2014, about 850 properties earned a total of

\$27.8 million in property tax credits, of which the State reimbursed \$13.9 million. Since tax year 2000, an annual average of \$900,000 in enterprise zone income tax credits have been claimed. About 100 tax returns claimed \$634,900 in income tax credits in tax year 2010.

Pursuant to the Tax Credit Evaluation Act of 2012, the Department of Legislative Services (DLS) evaluated the enterprise zone tax credit and made several recommendations in a draft report issued in November 2013. These findings included:

- **Enterprise zone tax credits are not effective in creating employment opportunities for enterprise zone residents:** While enterprise zone tax credits may incentivize some businesses to create additional jobs within enterprise zones, the tax credit is not particularly effective in providing employment to zone residents that are chronically unemployed and/or live in poverty. Additionally, annual claims for the enterprise zone income tax credit have been modest, and administrative burdens associated with the enhanced credit for members of a disadvantaged family may be contributing to low utilization rates.
- **In a significant number of zones, few businesses are claiming the credit:** Some enterprise zones have failed to attract many businesses, and a number of the businesses claiming the tax credit are not making significant investments in those zones.
- **DBED, SDAT, and local governments do not have a framework or metrics in place for measuring the effectiveness of the credit:** There is a lack of (1) accurate data on the change in employment and number of businesses within enterprise zones, which has hindered the ability to assess the impact of the credit and (2) standardization in the data that each county assessment office provides about properties claiming the enterprise zone property tax credit.
- **Enterprise zone expansions have become more prevalent:** Utilization of the property tax credit has greatly increased in recent years. There are few limitations on zone expansions and no specific criteria related to zone expansion requirements. The program is not subject to an overall limitation on what can be spent each year, and program costs may increase significantly as credits are granted to properties in new development projects.

DLS made recommendations on improving the effectiveness of the enterprise zone tax credit, which included reducing the administrative burden of claiming the income tax credit, adopting formal metrics and a framework for analyzing the cost-effectiveness of the enterprise zone incentives, evaluating the criteria for enterprise zone expansions, and providing uniform enterprise zone tax credit data collection procedures in each county.

The DLS evaluation of the enterprise zone tax credit can be found at: <http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013-Evaluation-Enterprise-Zone-Tax-Credit-DRAFT.pdf>.

Business Tax Credits and Financial Assistance

Since the establishment of the enterprise zone program the State has created almost 30 additional business tax credits. Of the current business tax credits, about one-quarter are employment tax credits and one-half are related to economic development. Employment tax credits include the enterprise zone, job creation, businesses that create new jobs, One Maryland, and health enterprise zone credits. State incentives that target distressed or similar areas include the enterprise zone, job creation, community investment, and sustainable communities tax credits. State business assistance programs which provide loans and grants or develop property for business use include MEDAAF, MIDFA, MSBDFA, and Maryland Economic Development Corporation. In addition, local governments have established and expanded the use of financial assistance, job creation, and economic development tax credits; tax increment financing, payment-in-lieu-of-taxes; and special taxing districts in order to subsidize infrastructure and development within targeted areas. These State and local programs are in addition to federal tax incentives which aim to encourage employment and investment.

In its draft evaluation of the One Maryland tax credit, issued in October 2013, DLS noted that there was significant overlap between existing State tax credit and business assistance programs. DLS estimated that only 3 or 9% of the 33 One Maryland projects in Baltimore City did not receive additional assistance from the specified programs. A little more than one-half of all projects received at least one type of additional assistance while the remaining 39% received multiple types of additional assistance.

State Revenues: State revenues will decrease as a result of income tax credits claimed against the personal and corporate income tax. The amount of the State revenue loss depends on the number and size of the zones, the location of the zones, and the amount of qualifying business activity that occurs in each zone. There is no limitation on the total number of zones that can be designated or the size of the zone. The estimate is based on the existing enterprise zone tax credit program, and assumes that RISE zones will be significantly smaller in size. In addition, the characteristics of RISE zones may be significantly different than that of enterprise zones.

Qualifying businesses within RISE zones can claim enterprise zone tax credits. As a result, general fund and special fund revenues will decrease beginning in the year in which eligible activity occurs. Since tax year 2000, an average of \$900,000 in enterprise zone income tax credits have been claimed, and income tax credits made up only 4% of

the total enterprise zone tax credit costs in tax year 2010. As a result, it is anticipated that State revenues will likely decrease by a maximum of \$100,000 annually.

State Expenditures: DBED may designate zones beginning in fiscal 2016. As a result, general fund expenditures increase by \$347,200 in fiscal 2016 due to implementation costs at DBED, SDAT, and the Comptroller's Office, as described below. In addition, State expenditures may decrease due to a savings in State enterprise zone reimbursements.

DBED advises that it would incur additional costs beginning in fiscal 2016 as a result of hiring one business development concierge. As a result, general fund expenditures increase by \$102,900 in fiscal 2016.

SDAT will incur additional costs beginning in fiscal 2016 as a result of hiring one administrator to process property tax credits. As a result, general fund expenditures increase by \$79,700 in fiscal 2016. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

The Comptroller's Office reports that it will incur a one-time expenditure increase of \$164,600 in fiscal 2016 to add the business tax credit. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Positions	2
Salary and Fringe Benefits	\$172,680
Operating Expenses	9,912
SDAT/DBED Expenditures	\$182,592
Comptroller Expenditures	\$164,600
Total FY 2016 Expenditures	\$347,192

Future year expenditures for DBED and SDAT reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Property Tax Reimbursements

The bill does not prevent a business from claiming both the property tax credit proposed by the bill and the enterprise zone tax credit but specifies that a business located within a RISE zone that is also within an enterprise zone or focus area qualifies for enhanced property tax credits. To the extent the zones overlap and businesses claim RISE property tax credits, State reimbursement expenditures under the enterprise zone program may be mitigated. The amount depends on the overlap between the two programs, if any, and the amount of qualifying investments made.

Local Revenues: Property tax and local income tax revenues will decrease in counties and municipalities in which a RISE zone is designated. In addition, local highway user revenues distributed to all counties and Baltimore City will decrease as a result of credits claimed against the corporate income tax. Each of the impacts is discussed below.

Property Tax

Property tax revenues in counties and municipalities in which a zone is designated will decrease as a result of the bill. The amount of the revenue loss depends on the number and size of the zones, the location of the zones, the amount of qualifying activity that occurs in each year, and whether an area designated as a RISE zone is currently designated as an enterprise zone.

In fiscal 2014, a total of \$2.4 billion in assessments was eligible for the enterprise zone property tax credit, of which \$1.1 billion was located in Baltimore City. These assessments are for credit activity within the last 10 years. The Baltimore City enterprise zone totals 13,450 acres, comprising a significant portion of Baltimore City's commercial areas. Within the last 10 years, an annual average of \$109.8 million in assessable property has become eligible for the credit in Baltimore City, which is a rough approximation of the eligible property investment in each year. The average property in Baltimore City had an eligible assessment (and investment) of \$3.8 million, with over 20 properties having an eligible assessment of over \$10.0 million. For each acre in an enterprise zone in Baltimore City, about \$8,200 in new investments are made each year. Utilization of the credit is significantly higher in Baltimore City than in other jurisdictions, as is the cost since the Baltimore City property tax rate is significantly higher than other jurisdictions.

Local Income Tax

Local highway user revenues distributed to Baltimore City, counties, and municipalities will decrease as a result of income tax credits claimed against the corporate income tax.

Tax Increment Financing

The bill extends the authority of counties and Baltimore City to issue bonds supported by TIF or other similar financing instruments in order to finance certain costs within a RISE zone. As a result, property and other tax revenues may increase for local governments that exercise their authority under the bill. A portion of local tax revenues generated in RISE zones may be dedicated to repayment of bonds issued by local governments. Annual debt service expenditures may increase significantly for local governments on bonds issued under the bill.

Small Business Impact: Small businesses located in an area designated as a RISE zone under the bill will potentially benefit from decreased property and income tax burdens. Conversely, any small businesses that are competitors of these businesses and do not qualify will be at a competitive disadvantage due to higher relative tax burdens.

Additional Information

Prior Introductions: None.

Cross File: SB 600 (Senator Pugh, *et al.*) - Budget and Taxation.

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

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