SB 560

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 560 (Senator Ferguson, *et al.*)
Budget and Taxation Ways and Means

One Maryland Economic Development Tax Credits - Business Incubators, Enterprise Zones, and Regional Institution Strategic Enterprise Zones

This bill expands the applicability of the One Maryland economic development tax credit to include a "business incubator" that (1) establishes or expands in an Enterprise Zone or a Regional Institution Strategic Enterprise (RISE) Zone; (2) meets the number of qualified positions requirement by aggregating the positions created by businesses at the facility; and (3) otherwise meets the eligibility requirements of the credit. The bill specifies additional requirements for the refundable portion of the project tax credit for all business incubators. Nonprofit business incubators may claim the refundable portion of the project tax credit and start-up tax credit in any taxable year following the year in which the project is placed in service or the business locates in an eligible area, respectively.

The bill takes effect July 1, 2016, and applies to all taxable years beginning after December 31, 2015.

Fiscal Summary

State Effect: General and special fund revenues decrease by $0.8 million in FY 2018, escalating to $2.3 million by FY 2021, and significantly thereafter, under the assumptions discussed below. The Department of Economic Competitiveness and Commerce (DOC) and the Comptroller can likely handle the bill's requirements with existing budgeted resources.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	$0	($0.7)	($1.1)	($1.5)	($2.0)
SF Revenue	$0	($0.1)	($0.2)	($0.3)	($0.4)
Expenditure	0	0	0	0	0
Net Effect	$0.0	($0.8)	($1.3)	($1.8)	($2.3)

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

Local Effect: Local highway user revenues (LHURs) decrease minimally beginning in FY 2018 from additional One Maryland credits claimed against the corporate income tax (CIT). Expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Bill Summary: For a business incubator, for any taxable year, the total amount used as a project tax credit and claimed as a refund may not exceed an amount equal to (1) the amount of tax that the businesses at the business incubator's facility are required to withhold for the taxable year from the wages of qualified employees and (2) 7.5% of the amount paid by businesses at the business incubator's facility to independent contractors who meet specified requirements.

Nonprofit business incubators may claim refundable tax credits beginning in the taxable year after the project is placed in service or the business locates in an eligible area (*i.e.*, the second taxable year), rather than after the fifth taxable year under current law. (Businesses that pay wages of at least 250% of the federal minimum wage may claim refundable credits after the third taxable year under current law.)

Current Law/Background: A "business incubator" means a program in which units of space are leased by multiple early-stage businesses that share physical common space, administrative services and equipment, business management training, mentoring, and technical support.

One Maryland Program

Generally, under the One Maryland program, businesses that (1) establish or expand a business facility in a priority funding area; (2) are located in a qualified distressed county; and (3) are primarily engaged in specified business activities may be entitled to tax credits for costs related to the new or expanded facility. Baltimore City and Allegany, Caroline, Dorchester, Somerset, Wicomico, and Worcester counties are currently considered qualified distressed counties.

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 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. Qualifying costs and expenses include those incurred with the acquisition, construction, rehabilitation, installation, and equipping of an eligible project. Eligible costs include land acquisition, performance and contract bonds, insurance, architectural and engineering services, environmental mitigation, and utility installation. The business must expend at least $500,000 in project costs.

Credits may be carried forward up to 14 successive tax years. Generally, a business entity must maintain at least 25 qualified employees at the project to carry over a tax credit from the preceding year. A prorated credit may be taken if the number of qualified positions filled by the business entity falls below 25, but does not fall below 10, and the business entity has maintained at least 25 qualified positions for at least 5 years.

In the first five years of claiming the credit, a business may claim the start-up credit against the company's Maryland income tax liability and the project credit against the income tax attributable to the qualifying project. Beginning in year six, companies generally are able to utilize more of the credit in each tax year – both credits may be claimed as a refund up to the amount of the withholding taxes attributable to the qualified employees working on the project. In addition, the project credit may also be applied to any remaining Maryland income tax liability. Provisions related to the refundable portion of the project and start-up credits apply after the third year after a business locates in a qualified distressed county if the pay of the majority of the qualified positions created from the establishment or expansion of the business facility is at least 250% of the federal minimum wage.

One Maryland Tax Credit Evaluation

In response to concerns about the impacts of tax credits, Chapters 568 and 569 of 2012 established the Tax Credit Evaluation Act, a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee. The committee was required to review and evaluate the One Maryland economic development tax credit by July 1, 2014. The final report on the credit was completed in August 2014 and can be found on the Department of Legislative Services (DLS) website.

The One Maryland tax credit is a high-value, low-utilization credit compared to other business tax credits. As of August 2014, DOC had certified a total of $197.4 million in One Maryland tax credits; however, only about one-third of this amount had been claimed at that time, thereby creating a large pipeline of unclaimed credits. Companies generally have 15 years to claim the entire amount of the credit; therefore, *existing* projects will continue to decrease State revenues by up to $136 million through tax year 2025 (fiscal 2026). This revenue loss is before any revenue losses that will result from new projects going forward from that date.

Enterprise Zones

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. The Secretary of Commerce 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 one-third of all Enterprise Zones have businesses that are concentrated within manufacturing, fabrication, transportation, warehousing, distribution, and research and development. This concentration typically results from either Enterprise Zone local standards restricting credit eligibility to these activities and industries or the establishment of the zone within an industrial or business park that has similar requirements.

Pursuant to the Tax Credit Evaluation Act of 2012, DLS evaluated the Enterprise Zone tax credit. The final report on the credit was completed in August 2014 and can be found on the DLS website.

There are currently 29 Enterprise Zones in 14 counties including Baltimore City. The largest Enterprise Zones are in Baltimore City and Harford and Prince George's counties. A list of all of the Enterprise Zones and a map of the current zones can be found on DOC's website.

RISE Zones

Chapter 530 of 2014 established the RISE Zone program, which is administered by DOC. The program provides specified income and property tax credits to qualifying business entities located within a geographic area designated as a RISE Zone. To be eligible to qualify, a business entity must:

- evidence an intention (1) to make a significant financial investment or commitment in an area of the State that the applicant intends to become a RISE Zone; (2) to use the resources and expertise of the applicant to spur economic development and community revitalization in an area of the State that the applicant intends to become a RISE Zone; and (3) to create a significant number of new jobs within a RISE Zone;

- have a demonstrated history of community involvement and economic development within the communities that the applicant serves; and

- meet the minimum financial qualifications established by the Secretary of Commerce.

RISE Zones must be located in the immediate proximity of a private or public four-year institution or community college. Currently, one RISE Zone has been approved, which is located directly adjacent to the University of Maryland, Baltimore, in the university's BioPark. There is a plan to build a business incubator at the location, which includes $17.5 million in tax increment financing funding from Baltimore City.

State Fiscal Effect: Under the assumptions discussed below, general and special fund revenues decrease in total by $0.8 million in fiscal 2018, escalating to $2.3 million by fiscal 2021. Future year revenues continue to decline significantly beyond fiscal 2021 as tax credits continue to be applied by qualified business incubators. The effect on general and special fund revenues is shown in **Exhibit 1**.

Exhibit 1
General and Special Fund Revenue Impacts
Fiscal 2017-2021
($ in Millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
General Fund	$0.0	($0.7)	($1.1)	($1.5)	($2.0)
HEIF	0.0	(0.0)	(0.1)	(0.1)	(0.1)
TTF	0.0	(0.1)	(0.1)	(0.2)	(0.3)
Total	**$0.0**	**($0.8)**	**($1.3)**	**($1.8)**	**($2.3)**

Note: Numbers may not sum to total due to rounding.

HEIF: Higher Education Investment Fund
TTF: Transportation Trust Fund

Source: Department of Legislative Services

According to the DLS evaluation of the One Maryland tax credit, the average credit awarded under the One Maryland program is $3.6 million. About one-third of all projects have been awarded the maximum $5.5 million credit. As noted above, there is currently only one RISE Zone, and a business incubator project is planned for the site. Enterprise

Zones are located around the State, with several large concentrations in Baltimore City and the areas surrounding Washington, DC. DLS is aware of at least four business incubators that are in an Enterprise Zone – all of which are in Baltimore City.

This estimate assumes (1) one project is certified in 2017 for the maximum credit amount of $5.5 million (in the RISE Zone); (2) one project is certified annually thereafter (likely in an Enterprise Zone) for the average program credit of $3.6 million; (3) the full amount of the credit is applied evenly over seven tax years; and (4) 75% of the credits are applied to CIT and 25% to the personal income tax. Any change in these assumptions alters the timing and amount of the revenue losses. Future RISE Zone and Enterprise Zone designations and/or a proliferation of business incubators may increase the above estimate.

This analysis assumes that no projects are certified in 2016, so there is no effect in fiscal 2017. If a project is certified in 2016, general and special fund revenues decrease as early as fiscal 2017, rather than fiscal 2018.

This estimate does not reflect the earlier refundable date for nonprofit business incubators; the effect on general fund revenues could accelerate if nonprofit business incubators claim refundable credits at an earlier date than authorized for business incubators that are not nonprofits.

DOC and the Comptroller can likely handle the bill's requirements with existing budgeted resources. To the extent that demand for the program exceeds either agency's ability to absorb the bill's administrative requirements, general fund expenditures increase for additional staff.

Local Revenues: Local governments receive a portion of Transportation Trust Fund revenues as LHURs for the purpose of constructing and maintaining local roads. Therefore, LHURs decrease by $8,300 in fiscal 2018, escalating to $24,500 by fiscal 2021, as a result of additional One Maryland credits being claimed against the CIT. Expenditures are not affected.

Small Business Effect: The bill offers a high-value tax credit to business incubators that would otherwise be ineligible to receive it. These business incubators benefit directly from up to a $5.5 million tax credit.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Commerce, University System of Maryland, State Department of Assessments and Taxation, Baltimore City, Montgomery County, Department of Legislative Services

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