SB 622

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 622 (Senator Pugh, *et al.*)
Budget and Taxation

Income Tax - Angel Investor Tax Credit Program

This bill creates a tax credit against the State income tax for investors that make qualified investments in Maryland innovation businesses. The credit is equal to 50% of the qualified investment, not to exceed $50,000 for an individual or $100,000 for married couples that file a joint return or a pass-through entity. The taxpayer can carry forward any unused credit for up to four succeeding tax years. The amount of credits that the Department of Economic Competitiveness and Commerce (DOC) 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, 2016, and applies to tax years 2016 through 2018. The bill terminates on June 30, 2023.

Fiscal Summary

State Effect: Potential significant general fund expenditure increase in FY 2017 through 2019. The amount of the expenditure increase depends on the amount of money, if any, appropriated to the reserve fund each year. If the credit is funded at $5.0 million, general fund expenditures increase by $5.0 million in FY 2017 through 2019. Administrative costs increase by $91,500 in FY 2017. Revenues are not affected.

($ in millions)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues	$0	$0	$0	$0	$0
GF Expenditure	5.1	5.1	5.1	0	0
Net Effect	($5.1)	($5.1)	($5.1)	$0.0	$0.0

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

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill establishes a Maryland Angel Investor Tax Credit Reserve Fund. The total amount of tax credit certificates issued by DOC in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. It is the General Assembly's intent that the Governor appropriate at least $5.0 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.

The credit is claimed by an accredited investor, as defined by the federal Securities and Exchange Commission, who (1) meets the qualifications of the bill; (2) follows the application and certification process established by the bill; and (3) invests in a qualified innovation business that is certified by DOC.

DOC may not certify investments in a single qualified innovation business 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 $10,000 ($20,000 for a pass-through entity or joint filer) in exchange for stock, convertible debt, or ownership interest. An investor may not acquire an ownership interest in a company that exceeds 20% and must submit an application to DOC.

A qualified innovation business is defined as a for-profit entity in a specified industry that has or is in the process of developing a technology, product, or service that is unique and legally owned or licensed by the business. A qualified innovation business does not include a qualified biotechnology company or a qualified cybersecurity company. A qualified innovation business must be in good standing as determined by the State Department of Assessments and Taxation (SDAT) and meet specified criteria, including requirements that the company (1) does not have annual revenue of more than $5 million; (2) has been in business for no more than five years; (3) has not received more than $3 million in investments; (4) has less than 35 full-time employees; (5) has its headquarters and base of operations in Maryland; (6) is not publicly traded on any exchange; and (7) has at least 51% of its full-time equivalent employees employed in the State and at least 51% of its payroll paid to the employees in the State.

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.

DOC is required to (1) approve tax credit applications; (2) determine the eligibility of qualified innovation businesses and investors; and (3) adopt regulations, in consultation with the Comptroller, to implement the credit. Additionally, the bill adds the tax credit to the list of economic development programs that DOC must report on to the Governor and the General Assembly each year.

Current Law: Chapter 99 of 2005 established the biotechnology investment tax credit, which offers a similar refundable tax credit for investments in qualified biotechnology companies. DOC administers the tax credit application, approval, and certification process and is required to submit a report to the Governor and the General Assembly detailing specified information about the tax credit each year. An investor who invests at least $25,000 in a qualified Maryland biotechnology company can claim a credit equal to 50% of the investment, not to exceed $250,000. DOC may not certify investments in a single biotechnology company that total more than 15% of the total appropriations to the reserve fund for that fiscal year.

Chapter 390 of 2013 established a refundable tax credit for investments in qualified cybersecurity companies. DOC administers the tax credit application, approval, and certification process and is required to submit a report to the Governor and the General Assembly detailing specified information about the tax credit each year. A qualified Maryland cybersecurity company can claim a credit equal to 33% of a qualified investment, not to exceed $250,000. A qualified investment is an at-risk investment of at least $25,000 in exchange for stock or ownership interest. DOC 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.

Background: Federal law defines an accredited investor as a person who:

- earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year; or
- has a net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence).

In addition, entities such as banks, partnerships, corporations, nonprofits, and trusts may be accredited investors.

The Washington Post reported last year that 27 states offer some form of tax credit for accredited investors that take a stake in early-stage companies.

State Fiscal Effect:

Appropriations to the Reserve Fund

It is the intent of the General Assembly that the Governor appropriate at least $5.0 million to the reserve fund in each year through fiscal 2019. Assuming the program is funded at this level, general fund expenditures will increase by $5.0 million annually through fiscal 2019. To the extent that the Governor provides less or no money to the reserve fund in any year, the increase in general fund expenditures will be less. To the extent that the Governor provides more than $5.0 million to the reserve fund in any year, the increase in general fund expenditures will be greater.

Revenue Impacts

Within 15 days after the end of each calendar quarter, DOC is required to notify the Comptroller of the total amount of final credit certificates that were issued during the quarter. Upon this notification, the Comptroller is required to transfer from the reserve fund to the general fund the total amounts stated in the final credit certificates that were issued during the quarter.

It is assumed that taxpayers claim the credit in the tax year that corresponds to the fiscal year in which the Comptroller transfers funds to the general fund on notification of a certified credit. To the extent that taxpayers claim the credit or adjust estimated quarterly payments or withholdings in a different fiscal year from when the transfer is made, general fund revenues could increase in these fiscal years and potentially decrease by a corresponding amount in later fiscal years. This timing issue, however, does not alter the total overall cost of the bill.

Administrative Expenditures

General fund expenditures increase by $91,545 in fiscal 2017 due to implementation costs at DOC and the Comptroller's Office, as described below. SDAT can issue letters of good standing for qualified innovation businesses with existing resources.

The Comptroller's Office reports that it will incur a one-time expenditure increase of $32,000 in fiscal 2017 to add the credit to the personal income tax form. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

DOC indicates it would need one tax credit specialist to administer the program. However, the Department of Legislative Services advises that the added responsibilities incurred by this legislation are not permanent and could be performed by a contractual employee. General fund expenditures will increase by an estimated $59,545 in fiscal 2017, which reflects the bill's July 1, 2016 effective date. This estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Contractual Position	1
Salary and Fringe Benefits	$54,580
Other Operating Expenses	4,965
DOC Expenditures	**$59,545**
Comptroller Expenditures	**32,000**
Total FY 2017 Expenditures	**$91,545**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

This estimate does not include any health insurance costs that could be incurred for specified contractual employees under the State's implementation of the federal Patient Protection and Affordable Care Act.

Small Business Effect: Small businesses that are pass-through entities and make qualified investments in a qualified innovation business may benefit by claiming a tax credit against the individual income tax of up to $100,000 in fiscal 2017 through 2019. Qualified innovation businesses that have developed or are in the process of developing a technology, product, or service that is unique and legally owned or licensed by the business may benefit by increased investments from qualified investors.

Additional Information

Prior Introductions: A similar bill, HB 789 of 2015, received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, SB 584, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: HB 471 (Delegate Lierman, *et al.*) - Ways and Means.

Information Source(s): Department of Commerce, Comptroller's Office, Department of Budget and Management, State Department of Assessments and Taxation, *The Washington Post*, Department of Legislative Services

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md/jrb

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