Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1255 (The Speaker, *et al.*) (By Request - Maryland Economic Development and Business Climate Commission)

Ways and Means

Tax Credits - Evaluations and Sunset Provisions

This bill (1) requires additional tax credits to be reviewed by the Tax Credit Evaluation Committee under the Tax Credit Evaluation Act; (2) alters the time period for reevaluating the credits reviewed by the committee; (3) terminates the One Maryland, enterprise zone, Regional Institution Strategic Enterprise (RISE), biotechnology investment, and businesses that create new jobs tax credits effective June 1, 2021; and (4) requires the Comptroller to adopt certain procedures and protocols, including a private letter ruling process for tax guidance.

The bill takes effect June 1, 2016.

Fiscal Summary

State Effect: General fund expenditures may increase significantly beginning in FY 2018 due to implementation costs at the Comptroller's Office. General fund expenditures decrease significantly beginning in FY 2022 due to the termination of the biotechnology investment and enterprise zone tax credits. State revenues increase significantly beginning in FY 2022 due to the termination of specified State tax credits.

Local Effect: Local property tax revenues and local highway user revenues increase significantly beginning in FY 2022 due to the termination of specified State and local tax credits. Local expenditures are not affected.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Tax Credit Terminations

The bill terminates, on June 1, 2021, the biotechnology investment and businesses that create new jobs tax credit programs and tax credits under the enterprise zone, One Maryland, and RISE programs. The terminations apply to tax years beginning after December 31, 2020.

Tax Credit Evaluation

The bill adds the cybersecurity investment incentive, RISE, and job creation tax credits to the list of credits to be reviewed by the Tax Credit Evaluation Committee under the Tax Credit Evaluation Act.

Under current law, a tax credit designated for evaluation under the Tax Credit Evaluation Act is subject to reevaluation five years after the initial evaluation. The bill increases this time period to seven years.

Comptroller's Office Requirements

The Comptroller must adopt procedures and protocols related to the administration of Maryland's tax system to (1) improve the accuracy and collection of tax data necessary to allow for more effective evaluations of State tax incentive programs; (2) notwithstanding any federal or State confidentiality requirements, share with the Department of Legislative Services (DLS) and other appropriate State agencies data related to State tax incentive programs to better assess the effectiveness of those programs; and (3) implement a private letter ruling process for tax guidance. If the Comptroller determines that adopting these procedures and protocols will have more than an incidental impact on the Comptroller's annual budget, the Comptroller must request additional resources in the agency's fiscal 2018 budget request to the Governor.

Current Law:

Tax Credit Evaluations

The Tax Credit Evaluation Act of 2012 (Chapters 568 and 569) established a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee that is appointed jointly by the President of the Senate and Speaker of the House.

By October 31 of the year prior to a tax credit's evaluation date, DLS is required to publish a report evaluating the tax credit. The report submitted by DLS must discuss (1) the purpose for which the tax credit was established; (2) whether the original intent of the tax credit is still appropriate; (3) whether the tax credit is meeting its objectives; (4) whether the goals of the tax credit could be more effectively carried out by other means; and (5) the cost of the tax credit to the State and local governments. By December 14 of the same year, the evaluation committee must hold a public hearing on the evaluation report.

By the twentieth day of the legislative session before the evaluation date of a tax credit, the committee is required to submit a report to the General Assembly that states whether or not the tax credit should be continued, with or without changes, or terminated.

The Act specifies the year in which a tax credit must be evaluated. In lieu of the specified evaluation date, if a tax credit has a termination date provided for by law, an evaluation of that credit must be made on or before July 1 of the year preceding the calendar year of the termination date.

Under current law, the following credits are to be reviewed by the date indicated:

- July 1, 2014: enterprise zone and One Maryland economic development credits;
- July 1, 2015: earned income and film production activity credits;
- July 1, 2016: sustainable communities credit;
- July 1, 2017: businesses that create new jobs, biotechnology investment, and wineries and vineyards credits; and
- July 1, 2020: research and development tax credit.

Tax Credit Programs

Businesses and individuals can claim a credit for qualifying activities under the biotechnology investment, businesses that create new jobs, cybersecurity investment, enterprise zone, job creation, One Maryland, and RISE tax credit programs, as discussed below.

Background:

Maryland Economic Development and Business Climate Commission

In March 2014, the President of the Senate and the Speaker of the House of Delegates appointed the Maryland Economic Development and Business Climate Commission to focus on the State's economic development structure and incentive programs in order to make recommendations to the Presiding Officers. The commission's 26 members come from a broad spectrum of backgrounds and have had business involvement in many states, as well as abroad.

A report containing 10 findings and 32 recommendations was submitted to the Presiding Officers in February 2015. The principal finding of the commission is that Maryland has not nearly reached its potential in growing business and creating jobs. The recommendations in the report address various short- and long-term aspects of this principal finding and related findings. As a result, five pieces of legislation were enacted into law during the 2015 session that addressed many of the commission's recommendations.

In March 2015, the Presiding Officers asked the commission to review and make recommendations on certain tax issues affecting economic development and the State's business climate. In a report issued in January 2016, the commission offered 14 recommendations to improve the State's business tax structure, 13 of which were proposed for implementation at the present time and a fourteenth, a reduction in individual income taxes, that should be implemented when other recommendations have been assimilated and the State's revenues and economy have strengthened.

The commission found that Maryland's current tax structure is a detriment to the State's competitiveness in attracting and retaining businesses as well as in creating jobs and expanding the revenue base of the government itself. The commission also found, however, that the State has many competitive advantages, particularly an educational system that has helped produce one of the most highly qualified workforces in the nation.

This bill reflects several of the commission's findings, including (1) there are too many, too small, and often uncoordinated and ineffectual tax credit and incentive programs targeting economic development in the State; (2) evidence that tax credits help businesses create or maintain jobs is mixed at best; (3) a lack of meaningful data about tax credit claims makes it difficult to evaluate tax credits; and (4) businesses currently lack tax guidance needed to responsibly manage their affairs.

Based on these findings, the committee recommended that the State (1) rigorously evaluate tax incentive programs and make changes necessary to assure that these programs are effective; (2) provide sunset provisions when approving business tax credits and amend the Tax Credit Evaluation Act to provide for periodic review of tax credits well before the related sunset provisions take effect; (3) develop methods to better analyze and track claims for tax credits, particularly for tax credits that are filed electronically, and to report such information to the Governor and General Assembly; and (4) institute a private letter ruling process to provide tax guidance and adopt an appropriate administrative fee to be paid by the requesting taxpayer.

The January 2016 report of the commission can be found here.

Tax Credit Evaluation Committee

To date, the tax credit evaluation committee has reviewed the enterprise zone, One Maryland, earned income, film production activity, and sustainable communities tax credit programs. Pursuant to its most recent evaluation, the committee has introduced Senate Bill 759/House Bill 939 of 2016 that includes the committee's recommended changes to the sustainable communities tax credit program, including a proposed extension of the program through fiscal 2022.

The DLS evaluations of the Enterprise Zone, One Maryland, earned income, film production activity, and sustainable communities tax credit programs can be found on the DLS website.

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. A qualifying business may receive (1) a property tax credit for local real and personal property taxes imposed on qualified property; (2) an income tax credit for the qualified employees hired by the business; and (3) consideration for assistance from Department of Commerce financial assistance programs. Businesses located within a focus area qualify for enhanced credits.

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 2017, about 788 properties will earn a total of $39.4 million in property tax credits, of which the State will reimburse $19.7 million. Since tax year 2000, an annual average of $900,000 in enterprise zone income tax credits have been claimed.

One Maryland

The One Maryland economic development tax credit was established to assist businesses with the costs of economic development projects undertaken in qualified economically distressed counties and specifically to encourage capital investment and job creation in those counties. A business in a qualifying industry that establishes or expands a business facility in a priority funding area and is located in a qualified distressed county may be entitled to an income tax credit of up to $5.5 million. From calendar 2001 through 2010 the Department of Commerce awarded a total of $222.5 million in credits to 54 projects. For tax year 2013, the most recent year for which data is available, a total of $10.4 million in income tax credits have been claimed to date.

Biotechnology Investment

Chapter 99 of 2005 established the biotechnology investment tax credit, which offers a refundable tax credit for investments in qualified biotechnology companies. 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. Generally, the total amount of tax credits issued in the fiscal year cannot exceed the amount appropriated to the biotechnology investment tax credit reserve fund in that year. The Governor's proposed fiscal 2017 budget includes $12 million in funding for the program.

Cybersecurity Investment

Chapter 390 of 2013 established a tax credit for investments in qualified cybersecurity companies. 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. Generally, the total amount of tax credits issued in the fiscal year cannot exceed the amount appropriated to the Maryland cybersecurity investment tax credit reserve fund in that year. The Governor's proposed fiscal 2017 budget includes $2 million in funding for the program. The credit terminates on June 30, 2019.

RISE Zones

Chapter 530 of 2014 established the RISE Zone program, which is administered by the Department of Commerce. RISE zones must be located in the immediate proximity of a private or public four-year institution or community college. A business may be eligible for (1) a property tax credit for local real and personal property taxes imposed on qualified property; (2) an income tax credit for the qualified employees hired by the business; and (3) priority consideration for assistance from Department of Commerce financial assistance programs. Businesses located within a focus area qualify for enhanced credits. One RISE zone has been approved to date, which is located directly adjacent to the University of Maryland, Baltimore, in the university's BioPark.

Job Creation

Businesses that expand or establish a facility in Maryland resulting in the creation of at least 60 new jobs within a two-year period may be eligible to claim the job creation tax credit. The value of the credit depends on the number of jobs created, the wages of those jobs in the year the credit was claimed, and whether the jobs were created in a revitalization area. In the last several years an average of 50 businesses have claimed about $500,000 in job creation tax credits annually. The program terminates January 1, 2020.

Businesses that Create New Jobs

Businesses located in Maryland that create new positions and establish or expand business facilities in the State may be entitled to a tax credit. To be eligible for the tax credit, businesses must first have been granted a property tax credit by a local government for creating the new jobs. The business must create at least 25 new positions as part of the new or expanded business facility. An enhanced credit is available if certain conditions are met and the program provides for a separate calculation of the credit for businesses located in Montgomery County. Due to confidentiality requirements at the Comptroller's Office, the amount of income tax credits claimed in each year is unknown.

Private Letter Rulings

The publication of tax guidance is generally considered a key feature of fair and efficient tax administration. Guidance in many states is provided through private letter rulings, which are written statements issued to a taxpayer that interpret and apply tax laws to the taxpayer's represented set of facts. This guidance generally may not be relied on as precedent by other taxpayers. The degree to which a private letter ruling is binding on the tax administrator that issues the guidance varies from state to state.

The Comptroller's Office currently issues declaratory rulings in response to petitions by taxpayers for formal guidance with respect to the applicability to a person, property or state, of facts pertaining to the laws or the regulations administered by the Comptroller. Although the Comptroller's Office has published a number of frequently asked questions for individual and business taxpayers on its website and offers "tax tips" for taxpayers, Maryland does not currently issue tax guidance through private letter rulings. According to the Council on State Taxation, 33 states issue some type of private letter rulings.

State Revenues: General fund, Transportation Trust Fund, and Higher Education Investment Fund revenues will increase beginning in fiscal 2022 due to the termination of the businesses that create new jobs, enterprise zone, and One Maryland tax credits. Based on recent claims, State revenues will increase by at least $12 million annually beginning in fiscal 2022.

State Expenditures: State expenditures increase beginning in fiscal 2018 due to implementation costs at the Comptroller's Office and decrease significantly beginning in fiscal 2022 due to the termination of specified credits. Each of the fiscal impacts is discussed below.

Enterprise Zone Termination

The State reimburses local governments for one-half of the cost of the enterprise zone property tax credit. Based on recent reimbursements, terminating the program will decrease general fund expenditures by at least $20.0 million annually beginning in fiscal 2023.

Biotechnology Investment Termination

Generally, the total amount of tax credits issued in a fiscal year cannot exceed the amount appropriated to the Biotechnology Investment Tax Credit Reserve Fund in that year. Based on the proposed fiscal 2017 funding for the program, general fund expenditures will decrease by at least $12.0 million beginning in fiscal 2022.

Comptroller's Office

The Comptroller must adopt procedures and protocols related to the administration of Maryland's tax system to (1) improve the accuracy and collection of tax data necessary to allow for more effective evaluations of State tax incentive programs and (2) implement a private letter ruling process. If the Comptroller determines that adopting these procedures and protocols will have more than an incidental impact on the Comptroller's annual budget, the Comptroller must request additional resources in the agency's fiscal 2018 budget request to the Governor.

As a result, general fund expenditures may increase significantly beginning in fiscal 2018. The Comptroller's Office advises that general fund expenditures may increase by a total of $1.2 million in fiscal 2018, which reflects:

- $650,000 due to programming costs to improve the accuracy and collection of tax credit data; and
- $502,000 to implement a private letter ruling process reflecting the hiring of two tax consultants, two assistant State Comptrollers, and one administrative specialist.

DLS can implement the bill within existing budgeted resources.

Local Revenues: Local property tax revenues will increase by at least $20.0 million annually beginning in fiscal 2022 due to the termination of the enterprise zone and RISE tax credit programs. Local highway user revenues will increase significantly beginning in fiscal 2022 due to the termination of the RISE, enterprise zone, biotechnology incentive investment, One Maryland, and businesses that create new jobs income tax credits.

Small Business Effect: Any small business that benefits from the tax credits terminated under the bill will be negatively impacted.

Additional Information

Prior Introductions: None.

Cross File: SB 843 (The President) (By Request - Maryland Economic Development and Business Climate Commission) - Budget and Taxation.

Information Source(s): Comptroller's Office; Department of Legislative Services

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