Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 386 (The President, *et al.*) (By Request - Administration)
Budget and Taxation

Tax Credits - Manufacturing Empowerment Zones

This Administration bill establishes the Manufacturing Empowerment (ME) Zone Program, to be administered by the Department of Commerce. A qualified business entity engaged in manufacturing that locates in an ME zone may be entitled to a 10-year (1) income tax credit for 100% of the qualified income attributable to the qualifying manufacturing facility and (2) property tax credit for local real and personal property taxes, to the extent provided by local law. The bill also exempts from the State income tax the qualified wages and salaries paid to certain employees employed by qualifying manufacturing entities within a zone.

The bill takes effect June 1, 2016. The property tax credit provisions apply to all taxable years beginning after June 30, 2016, and the income tax provisions apply to all taxable years beginning after December 31, 2016.

Fiscal Summary

State Effect: State revenues may decrease significantly due to income tax credits claimed by qualifying business entities and an exemption from income tax for wage and salary income of certain qualifying employees. General fund expenditures increase beginning in FY 2017 due to implementation costs.

Local Effect: Real and personal property tax revenues in counties and municipalities in which a zone is designated may decrease significantly. Local income tax revenues and local highway user revenues will decrease due to tax credits claimed against the income tax and the exemption of specified wage and salary income. Local expenditures may increase minimally to administer the program.

Small Business Effect: The Administration has determined that the bill will have a meaningful impact on small business (attached). The Department of Legislative Services concurs with this assessment.

Analysis

Bill Summary: The ME zone program provides income tax incentives to qualifying manufacturing businesses within a geographic area designated as an ME zone by the Department of Commerce. The governing body of a county or municipality may also, by law, establish a tax credit against real and personal property taxes for qualifying property within an ME zone. A business qualifies if it (1) operates or conducts a trade or business that is engaged in manufacturing; (2) makes a capital investment or increases employment; (3) does not have an economic presence in the State prior to locating in the zone; and (4) meets the requirements specified for each incentive. A qualified business includes a business that operates or conducts a trade or business that is engaged in manufacturing or research and development (R&D) activities and specified businesses within the computer software and biotechnology industries.

The Secretary of Commerce may establish by regulation any other requirements necessary to implement the bill. The Department of Commerce 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.

Zone Designations

The Secretary of Commerce may designate an area as an ME Zone if the area is within a priority funding area or meets an exception under Title 5, Subtitle 7B of the State Finance and Procurement Article. The area must also meet at least one of the following criteria:

- within the last 18 months have an average unemployment rate that is at least 150% greater than either the State or national rate;
- have a population that qualifies the area as a low-income poverty area;
- be composed of at least ten contiguous census tracts that the Secretary has determined have undergone a sudden and severe period of economic distress;
- be adjacent to a federal military installation; or
- be within one-half mile of a current or planned MARC commuter train, Baltimore metro subway, Baltimore Maryland Transit Administration (MTA) light rail, or State metrorail system station.

For the purposes of the unemployment and low-income poverty criteria, the area meets the requirement if an area in a reasonable proximity to the area but within the same county meets the specified requirements. Before designating a zone, the Secretary must consult with the political subdivision in which the zone is to be located.

The Secretary of Commerce may designate up to six zones in a calendar year and approve up to two zones in a county within the same calendar year. ME zone designations are effective for 10 years. The bill also establishes the criteria for expanding an existing zone.

Program Incentives

The Department of Commerce may award incentives to a qualifying business that moves into or locates in an ME zone on or after the date that the zone is designated and creates jobs or makes a qualifying capital investment if (1) the business conducts its trade on real property it owns within the zone; (2) the Secretary determines that the business entity did not have an economic presence in the State prior to locating in the zone; and (3) the business meets the requirements specified for each incentive.

A qualifying manufacturing business includes companies engaged in (1) research and development activities, whether or not the company has a product for sale; (2) the identification, design, or genetic engineering of biological materials for research or manufacture; and (3) the design and development of computer software for sale, lease, or license.

A qualifying business may qualify for (1) a property tax credit for local real and personal property taxes imposed on a qualified property of a manufacturing business; (2) an income tax credit for 100% of the qualified income attributable to the qualifying manufacturing facility; and (3) consideration for assistance from Department of Commerce financial assistance programs, if the Secretary of Commerce determines that the business creates jobs. These programs include the Maryland Economic Adjustment Fund, Maryland Economic Development Assistance Authority and Fund, Maryland Industrial Development Financing Authority, and Maryland Small Business Development Financing Authority.

In addition, the wages and salaries paid to the employees of the qualifying manufacturing facility are exempt from State and local income taxes, if the qualified income is attributable to the activities in the manufacturing zone and the total income of an employee derived from the facility in the taxable year is less than $65,000.

Property Tax Credits

The governing body of a county or municipality may provide for a property tax credit against local real property taxes imposed on the eligible assessment of qualified property owned by an eligible business entity. Qualified property is real property that is not used for residential purposes, used in a manufacturing trade or business by a business entity, and located in an ME zone.

The property tax credit is applied against the assessment increases resulting from the value of real property improvements, as calculated by the State Department of Assessments and Taxation (SDAT). Property tax credits can be claimed for 10 taxable years.

In addition, local governments may establish a credit against the personal property taxes imposed on eligible personal property that is used in a manufacturing trade and primarily located on real property that is granted a property tax credit under the program.

Income Tax Incentives

A qualified business entity may claim a tax credit against the State income tax for 100% of the income attributable to activities at a manufacturing facility located in an ME zone. A qualified business entity must be engaged in a manufacturing trade or business and be eligible for a real property tax credit under the program. The income tax credit may be claimed for up to 10 taxable years beginning with the taxable year following the calendar year in which the business property becomes eligible for a property tax credit.

The bill also exempts the wages and salaries paid to employees of a qualifying manufacturing facility if (1) the qualified income is attributable to activities at a manufacturing facility located in an ME zone and (2) the business entity meets the qualifications of the program and is eligible for the real property tax credit. The exemption does not apply to an individual who during the taxable year has more than $65,000 in qualified income.

Current Law/Background: Numerous federal and State incentives are available to manufacturing businesses. These programs include similar zone-based programs available to businesses in different types of industries and specific incentives targeted to manufacturing businesses. These incentives include:

- the Enterprise Zone Program;
- the One Maryland Program; and
- single sales factor apportionment for qualifying manufacturers.

Enterprise Zone Property Tax Credits

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, the Department of Legislative Services (DLS) evaluated the enterprise zone tax credit and made several recommendations in a report issued in August 2014. 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 who 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.

- **The Department of Commerce, 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 here.

One Maryland Program

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, businesses within the manufacturing industry claimed the largest amount of credits – of the 54 projects that received a total of $222.5 million in credits under the program, 18 were manufacturing projects that were awarded a total of $79.6 million in credits. Projects located in areas other than Baltimore City had a higher concentration of projects within the manufacturing industry, as these projects claimed the majority of credits in these counties.

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. These are in addition to State business assistance programs that provide loans and grants or develop property for business use. Local governments have also established and expanded the use of financial assistance, job creation, and economic development tax credits; tax increment financing; payment-in-lieu-of-taxes agreements; 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 that aim to encourage employment and investment.

In its evaluation of the One Maryland tax credit, issued in August 2014, 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. The DLS evaluation of the One Maryland tax credit can be found here.

Single Sales Factor Apportionment

Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use a three-factor apportionment formula of payroll, property, and sales, with sales double weighted. Chapter 633 of 2001 specified that qualifying manufacturing corporations allocate income to Maryland based on a single-factor formula consisting solely of sales. The Comptroller's Office estimates that the special allocation of income for manufacturers decreased tax year 2010 corporate income tax revenues by $21.4 million. This loss equates to a reduction of about 14% of the $154.3 million tax year 2010 liability of all manufacturers (excluding refiners, who are exempt from using single-sales apportionment) and about 2.7% of total corporate income tax liability.

Additional State Tax Incentive Programs

Several State tax incentives are intended to promote economic development within the R&D, computer software, and biotechnology industries, including the R&D, cybersecurity investment, and biotechnology investment incentive tax credits. The State also exempts from the State sales and use tax (1) tangible personal property used predominantly in a production activity and (2) sales of items used for R&D purposes. In addition, the Base Realignment and Closure Revitalization and Incentive Zone tax credit program has some of the same criteria proposed by the bill for an ME zone.

State Employment Trends and Manufacturing Employment

Changes in employment over time reflect the net impact of many factors, including shorter term impacts such as recessions, as well as longer term trends impacting the demand for products within industries and technological changes. These trends often differ across industries, as the Maryland and national economies have shifted away from goods-producing industries to service economies. The share of the United States employed within manufacturing and agriculture since World War II has declined from about one-third to a little more than 10%. Employment within the services industry doubled from about one-quarter to one-half. Although manufacturing employment has fallen within the United States, output continues to increase, reflecting more widespread use of technology that increases productivity. In the second quarter of 2015, Maryland manufacturing businesses employed a total of 103,909 workers, about 4% of Maryland's total nonfarm employment.

The manufacturing industry's share of the Maryland economy (about 8%) is about double its share of total employment, and the industry remains the second largest source of corporate income tax revenues.

Since 1990, total Maryland nonfarm employment has increased by 432,300 or about one-fifth. Most of this increase has been driven by growth in the education and health services and professional and business services industries. Employment within these industries increased by 371,100 since 1990, and businesses within these industries employ one out of every three people in the State. Conversely, since 1990, employment within the construction, logging, and mining and manufacturing industries has fallen by 104,400. **Exhibit 1** shows the change in Maryland employment by sector since 1990.

Exhibit 1
Maryland Employment by Sector
1990-2015

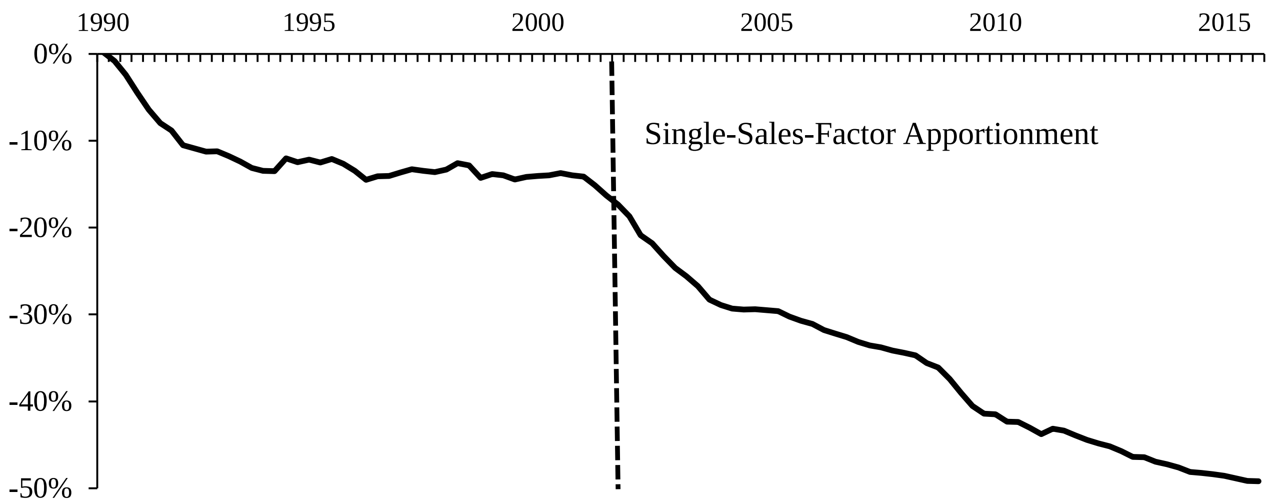
Employment Sector	1990	2000	2015	% Change
Construction, Logging, and Mining	163,700	158,000	153,500	-6.2%
Manufacturing	198,100	172,100	103,900	-47.6%
Trade, Transportation, Utilities	447,000	465,900	455,300	1.9%
Information	47,400	56,900	38,700	-18.4%
Financial Activities	136,100	146,000	139,000	2.1%
Professional and Business Services	255,800	363,000	430,800	68.4%
Education and Health Services	221,800	302,500	417,900	88.4%
Leisure and Hospitality	184,000	201,900	275,600	49.8%
Other Services	96,500	112,600	91,600	-5.1%
Government	420,400	447,600	496,800	18.2%
Total Nonfarm Employment	**2,170,800**	**2,426,500**	**2,603,100**	**19.9%**

Source: U.S. Bureau of Labor Statistics; Department of Legislative Services

Exhibit 2 shows the cumulative change in quarterly employment within the Maryland manufacturing industry from 1990 to the first quarter of 2015. Exhibit 2 also shows when multistate manufacturers were required to apportion income based on a single-sales factor.

Despite this measure intended to spur economic growth and employment in the industry, total employment continued to decline, reflecting the influence of recessions and technological, national, and international economic influences impacting the industry. Employment fell by 26,000 from 1990 to 2000 and by 68,000 from 2000 to 2010. Manufacturing losses have accelerated since 2000 – annual losses increased from 1.6% between 1990 and 2000 to 3.3% since 2000.

Exhibit 2
Cumulative Change in Maryland Manufacturing Employment
1990-2015



Source: U.S. Bureau of Labor Statistics; Department of Legislative Services

State Revenues: State revenues will decrease as a result of income tax credits claimed by qualifying businesses. In addition, the bill exempts from the State income tax wages and salaries paid to certain employees of a qualifying business. The amount of the State revenue loss depends on the number and size of the zones, the locations of the zones, the number of employees eligible for the income tax exemption, and the amount of qualifying business activity that occurs in each zone. Except that new zone designations are limited to six per year, there is no limitation on the total number of zones that can be designated or the size of the zones. In addition, revenue losses will occur based on the types of businesses that qualify for the program. Given that the bill exempts 100% of the income attributable to a qualifying entity, the revenue loss per qualifying entity could be significant.

State Expenditures: General fund expenditures increase in fiscal 2017 due to implementation costs at the Comptroller's Office, as described below. In addition, State expenditures may decrease due to a reduction in State enterprise zone reimbursements.

The Comptroller's Office reports that it will incur a one-time expenditure increase of $92,000 in fiscal 2017 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. The Comptroller's Office also reports it will incur additional expenditures to conduct (1) additional compliance and tax return processing and (2) an assessment of the credit's effectiveness.

Property Tax Reimbursements

Qualifying businesses within ME zones may be entitled to claim both the property tax credits proposed by the bill and enterprise zone tax credits. To the extent that the zones overlap and businesses claim ME zone property tax credits, State reimbursements 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: Local income tax revenues will decrease in counties and municipalities in which an ME zone is designated. Local property tax revenues will decrease in counties and municipalities that provide property tax credits for eligible properties in ME zones. In addition, local highway user revenues distributed to local governments will decrease as a result of credits claimed against the corporate income tax, and local income tax revenues will decrease due to the exemption of qualified wage and salary income of qualified employees. Each of the impacts is discussed below.

Property Tax

Real and personal property tax revenues in counties and municipalities in which a zone is designated may decrease as a result of the bill, if the local jurisdiction authorizes the property tax credits. 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 an ME 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 and Local Highway User Revenues

Local income tax revenues will decrease due to the exemption of certain wages and salaries paid to the employees of the qualifying facility. In addition, 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.

Additional Information

Prior Introductions: SB 507 of 2015, a similar bill, was referred to interim study by the Senate Budget and Taxation Committee.

Cross File: HB 450 (The Speaker, *et al.*) (By Request - Administration) - Ways and Means.

Information Source(s): Department of Commerce, Comptroller's Office, State Department of Assessments and Taxation, Department of Legislative Services

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md/jrb

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ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: Tax Credits – Manufacturing Empowerment Zones

BILL NUMBER: SB386/HB450

PREPARED BY: Department of Commerce

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESS

OR

_X__ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

New small businesses located in an area designated as a zone under the bill will potentially benefit from decreased property and income tax burdens. Small businesses will potentially benefit from the increased economic activity located in and near a zone. Conversely, any small businesses that are competitors of these businesses and not taking advantage of current tax credit incentives may be at a competitive disadvantage due to higher relative tax burdens.