

Department of Legislative Services
Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 1134
(Senator Oaks)
Budget and Taxation

Income Tax - Research and Development Credit - Start-Up Businesses

This bill increases from 3% to 5% the value of the basic research and development (R&D) tax credit for a company that is a start-up business. A “start-up business” is a business entity organized in the State whose first contract of sale to a paying customer was signed less than two years before the date of the entity’s application for the credit.

The bill takes effect July 1, 2017, and applies to all R&D tax credits certified after December 31, 2016.

Fiscal Summary

State Effect: Increasing the value of the credit for certain companies will not alter the fiscal impact of the program beyond that provided under current law.

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Chapters 515 and 516 of 2000 established the Maryland research and development tax credit. Companies that incur qualified R&D expenses in Maryland are entitled to the credit. There are two types of credits available to businesses: (1) a basic credit equal to 3% of the Maryland qualified R&D expenses paid during the tax year, up to the Maryland base amount; and (2) a growth credit equal to 10% of the Maryland qualified R&D expenses paid during the year that exceed the Maryland base amount. R&D expenses can typically be deducted as a business expense, resulting in lower federal and State income

tax liabilities. Businesses claiming the credit are required to add back to federal adjusted gross income or Maryland modified income the amount of any credits claimed. The R&D credit terminates June 30, 2021.

Chapter 109 of 2013 expanded the R&D tax credit by increasing from \$6 million to \$8 million the aggregate amount of credits that can be approved in each calendar year. Chapter 109 also allowed the credit to be refundable if the business claiming the credit is a for-profit corporation, limited liability company, partnership, or sole proprietorship that, at the beginning or end of the taxable year in which the eligible R&D expenses are incurred, has net book value assets totaling less than \$5 million. Chapter 525 of 2014 increased from \$8 million to \$9 million the aggregate amount of credits that can be approved in each calendar year.

Background:

Maryland Research and Development Credit

The amount of credits earned has substantially exceeded the aggregate limit each year; the amount approved for each credit is reduced by a proportional amount of the excess. For example, the Department of Commerce reduced from \$29.2 million to \$4.0 million the total amount of basic credits awarded in tax year 2012. In tax year 2011, the basic credit was equal to 0.33% of eligible expenses compared with a statutory rate of 3%, while the growth credit rate was reduced from 10% to 1.65%. In addition, the deductibility of State and local taxes paid for federal income tax purposes, the requirement that companies claiming the credit add back the amount of credit claimed, and credit carry forwards further dilute the amount of the incentive provided.

The Department of Commerce awarded a total of \$54 million in credits to 284 companies between tax year 2000 and 2008. Ten corporations earned a little more than one-half of all credits (\$28.5 million) during that time period. Credits were awarded most frequently to companies in the following sectors: pharmaceutical and medicine manufacturers (38%); bioscience (14%); computers (12%); and aerospace/defense (11%). The Department of Legislative Services estimates that a little over half of the companies that were awarded credits in tax year 2005 were headquartered in Maryland – these companies were awarded approximately 37% of all credits.

State Fiscal Effect: The bill increases the value of the basic R&D tax credit if the company meets the bill's proposed requirement. The bill will not alter the overall fiscal impact of the tax credit program as it is expected that under current law the Department of Commerce will award the maximum of \$4.5 million in basic tax credits in each year.

Small Business Effect: Start-up businesses that can claim the basic credit will benefit; however, it is unknown what portion of these businesses qualify as a small business. Given the credit is oversubscribed and prorated based on the total amount of credits companies qualify for, increasing the credit awarded to certain companies will decrease the credit available to all other companies. Other small businesses that do not meet the bill's requirement will be negatively impacted from this reduction in the credit.

Additional Information

Prior Introductions: None.

Cross File: HB 1176 (Delegate Rosenberg, *et al.*) - Ways and Means.

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

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Analysis by: Robert J. Rehrmann

Direct Inquiries to:
(410) 946-5510
(301) 970-5510