

Department of Legislative Services
 Maryland General Assembly
 2017 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 89 (Chair, Ways and Means Committee)(By Request -
 Departmental - Commerce)

Ways and Means

Income Tax Credit - Security Clearances - Employer Costs - Extension

This departmental bill extends the termination date of the employer security clearance costs tax credit through tax year 2021.

The bill takes effect July 1, 2017.

Fiscal Summary

State Effect: General fund revenues decrease by \$1.6 million annually in FY 2019 through 2023 as a result of tax credits being claimed against the corporate and personal income tax. Transportation Trust Fund (TTF) revenues decrease by \$0.2 million annually and Higher Education Investment Fund (HEIF) revenues decrease by \$0.1 million annually in FY 2019 through 2023. Expenditures are not affected.

(\$ in millions)	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
GF Revenue	\$0	(\$1.6)	(\$1.6)	(\$1.6)	(\$1.6)
SF Revenue	\$0	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)
Expenditure	0	0	0	0	0
Net Effect	\$0.0	(\$1.9)	(\$1.9)	(\$1.9)	(\$1.9)

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

Local Effect: Local highway user revenues distributed from the corporate income tax decrease by \$19,300 annually in FY 2019 through 2023. Local income tax revenues increase by \$700 annually in FY 2019 through 2023 due to taxpayers adding back the amount of credits claimed against the personal income tax. Local expenditures are not affected.

Small Business Effect: The Department of Commerce has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services concurs with this assessment as discussed below.

Analysis

Current Law/Background: Chapter 478 of 2012 established the Employer Security Clearance Costs Tax Credit program. The program allows a tax credit against the State income tax for certain security clearance administrative expenses and for the construction and equipment costs to construct or renovate a sensitive compartmented information facility (SCIF) located in the State. To qualify, the security clearance administrative expenses must be incurred with regard to an employee in the State and include (1) processing application requests for clearances; (2) maintaining, upgrading, or installing computer systems in the State that are required for obtaining federal security clearances; and (3) training employees to administer the application process.

Chapter 482 of 2013 expanded the credit by specifying that expenses incurred for rental payments owed during the first year of a rental agreement for spaces leased in the State qualify for the credit, if the company qualifies as a small business and performs security-based contracting. A small business is a firm that (1) is independently owned and operated; (2) is not a subsidiary of another firm; (3) is not dominant in its field of operation; and (4) did not employ more than 25 individuals in its most recent fiscal year. Chapter 482 of 2013 also generally doubled the maximum value of the credit.

The amount of expenses that qualify for the credit are equal to (1) 100% of eligible security clearance administrative expenses, not to exceed \$200,000; (2) 100% of eligible rental payments, not to exceed \$200,000; and (3) 50% of eligible costs incurred to construct or renovate each SCIF, not to exceed \$200,000. If a company constructs and/or renovates multiple SCIFs, the total amount of aggregate expenditures that qualify for the credit is limited to \$500,000. If the total amount of the credit exceeds the tax liability imposed in the year, the excess can be carried forward to future tax years until the full amount of the excess is used. Businesses claiming the credit are required to add back to Maryland adjusted gross income or Maryland modified income the amount of expenses claimed under the credit.

The Department of Commerce is authorized to award a maximum of \$2.0 million in total credits each year, and credits may be claimed in tax years 2013 through 2016. If the amount of credits claimed in each year exceeds the maximum aggregate limit, the value of the credit is reduced based on the total amount of excess credits claimed. In tax year 2013, the

Department of Commerce awarded credits to 40 businesses. The median credit awarded was \$33,734. Five companies received a credit of \$100,000 or greater, with these companies receiving about 40% of all credits. In tax year 2014, the Department of Commerce awarded \$2.0 million in credits to 48 businesses that claimed \$8.25 million in employer security clearance costs. The median credit awarded was \$22,638. Six companies received a credit of \$100,000 or greater, with these companies receiving almost 50% of all credits.

State Revenues: The bill extends the termination date of the employer security clearance costs tax credit through tax year 2021. The Department of Commerce can award a maximum of \$2.0 million in credits annually in tax years 2017 through 2021. As a result, general fund revenues decrease by \$1.6 million annually in fiscal 2019 through 2023. TTF revenues decrease by \$200,900 annually, of which \$181,600 goes to the State, and HEIF revenues decrease by \$82,600 annually in fiscal 2019 through 2023.

Before claiming the tax credit, the Department of Commerce must certify the amount of expenses incurred by the business. These expenses are certified on December 15 of the calendar year following the end of the taxable year in which the qualifying expenses occurred. A business must then file an amended return to claim the credit – it is assumed that this could be done beginning in fiscal 2019 and that companies do not adjust estimated payments.

The estimated revenue loss due to the expansion is based on the following facts and assumptions:

- the maximum amount of credits will be awarded in each tax year;
- 75% of credits are claimed against the corporate income tax, with the remaining amount claimed against the personal income tax;
- businesses have enough tax liability to claim the full credit; and
- any credit claimed is added back to Maryland adjusted gross income or Maryland modified income.

Local Revenues: Local highway user revenues distributed from the corporate income tax decrease by \$19,300 annually in fiscal 2019 through 2023. Local income tax revenues increase by \$700 in fiscal 2019 through 2023 due to taxpayers adding back the amount of credits claimed against the personal income tax.

Small Business Impact: Any small business that incurs eligible expenses could be positively impacted by the program's extension. In 2013, an estimated one-third of

companies that were awarded the credit were small businesses. The credit received by these businesses ranged from \$5,100 to \$56,900.

Additional Information

Prior Introductions: A similar bill, SB 246 of 2016, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None designated; however, SB 138 (Senators Manno and Miller – Budget and Taxation) is identical.

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

Fiscal Note History: First Reader - January 30, 2017
mm/jrb

Analysis by: Heather N. Ruby

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

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES (SFY 2017)

TITLE OF BILL: Sunset Extension -Employer Security Clearance, Construction, Equipment and Small Business First-Year Leasing Costs Tax Credit

BILL NUMBER: HB 89

PREPARED BY: Mikra Krasniqi, Economist (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

Maryland has many small and medium sized businesses that do business with the federal government. Most of this work entails handling sensitive and classified material on national security and defense matters. This added layer of business complexity requires not only a deeper interaction with government agencies, but it also raises business costs and often deters business creation. Companies spend millions of dollars seeking and hiring talent with security-cleared backgrounds as well as investing in facilities, security-based contracts, and acquiring technology that meet the stringent security demands. Since 2012, the Maryland Employer Security Clearance Costs Tax Credit program has been addressing this issue by issuing tax credits to businesses that have incurred costs related to security clearance costs.

While the program is beneficial for all types of firms that interact with the federal government, these tax credits are especially important for startups and small businesses. Research shows that many new firms struggle with the volatility and dynamics of entering the market. Much of this is associated with high capital costs, access to affordable credit, and competing with more established firms in the market. In addition to dealing with these standard business barriers, small firms that are seeking to work with federal government are at a disadvantage as they face the extra layers of complexity and costs of navigating federal government bureaucracy and fulfilling requirements.

That the program is important to small firms is evident from applications that have been submitted by qualified firms from previous years. In 2013, 39 firms qualified for the tax credit. That number increased to 49 businesses in 2015. It's important to note that while both large and small companies have applied for the program, majority of the tax credit has been given to firms that

employ fewer than 100 workers . Roughly 75% of the businesses have fewer than 100 employees and 50% have fewer than 50 employees. The following chart shows in more detail recipient firms based on size of the business for years 2013 and 2014.

Firms by size that received the security-based tax credit for 2013 and 2014

	TY2013	TY2014
Less than 10	3	4
Less than 25	7	9
Less than 50	8	13
Less than 100	11	11
More than 100	10	11
Total	39	48

Source: Department of Commerce.