Department of Legislative Services

Maryland General Assembly
2018 Session

FISCAL AND POLICY NOTE
Third Reader

Senate Bill 564 (Senator Serafini)
Budget and Taxation Ways and Means

Income Tax Credit - Security Clearance Costs - Procedure to Claim Credit

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This bill alters the method by which an individual or corporation may claim the employer security clearance costs income tax credit by allowing a taxpayer to attach a copy of the tax credit certification to an income tax return filed for any taxable year after the taxable year in which the costs were incurred. **The bill takes effect July 1, 2018.**

Fiscal Summary

State Effect: State income tax revenues are not materially affected, as discussed below. The Comptroller's Office can implement the bill with existing resources.

Local Effect: Local highway user revenues are not materially affected. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: To claim the employer security clearance costs income tax credit, an individual or corporation must file an amended income tax return for the taxable year in which the costs were incurred and attach a copy of the tax credit certification to the amended income tax return.

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 (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 2021. 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, 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. The Comptroller’s Office reports taxpayers claimed approximately $1.2 million in tax credits, but since the tax credit is nonrefundable, less than 61% of credits were allowed, and the credits not allowed were carried forward.

In tax year 2014, 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. In tax year 2015, Commerce awarded $2.0 million in credits to 50 businesses that claimed $13.13 million in employer security clearance costs.

State Fiscal Effect: Since the bill only shifts the timing of receiving tax credits, State revenues are not materially impacted over the long term. Taxpayers still have the option to file an amended tax return to claim the tax credit. The Department of Legislative Services (DLS) assumes taxpayers will choose to file an amended tax return to claim the credit for the taxable year in which the costs were incurred if those taxpayers have sufficient tax liability in that year to use the credit.

If taxpayers who earned the tax credit do not have a tax liability in the tax year that costs were incurred, they receive no immediate benefit from filing an amended tax return. The credit is carried forward until they have sufficient tax liability to use the credit. DLS assumes these taxpayers will choose to claim the tax credit in a tax year after the taxable year in which costs were incurred. In this scenario, allowing a taxpayer the option of claiming the credit in a later year instead of filing an amended tax return does not impact tax revenues since the taxpayer did not receive an immediate benefit from filing an amended return and claiming the credit in the tax year that the costs were incurred.

To the extent that a taxpayer has a tax liability in the year that costs were incurred and opts to claim the tax credit in a future tax year instead of filing an amended tax return, general fund, Transportation Trust Fund (TTF), and Higher Education Investment Fund (HEIF) revenues may increase in the first year and decrease by a corresponding amount in later years. Since the bill only shifts the timing of receiving tax credits, State revenues are not impacted over the long term.

However, some taxpayers never claim tax credits that they have earned. To the extent that the bill encourages taxpayers who have not claimed the credit to now do so, general fund, TTF, and HEIF revenues may decrease.

The Comptroller's Office can implement the bill with existing resources. The bill may result in the Comptroller's Office not having to process as many amended tax returns, but any operational efficiencies are offset from the Comptroller's Office having to take additional steps to ensure that tax credits were not already claimed in an earlier tax year. Generally, taxpayers have three years from the date the original return was due to file an amended State tax return, but the bill has no time restraint for claiming the employer security clearance costs income tax credit in a year after the costs were incurred. Thus, the Comptroller's Office may have to check many prior tax returns to see if a taxpayer has previously claimed the credit.

Additional Information

Prior Introductions: None.

Cross File: None.

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

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