

Department of Legislative Services
 Maryland General Assembly
 2018 Session

FISCAL AND POLICY NOTE
 Enrolled - Revised

Senate Bill 228

(Senator Guzzone, *et al.*)

Budget and Taxation

Ways and Means

Cybersecurity Incentive Tax Credits

This bill extends through fiscal 2023 the termination date of the cybersecurity investment incentive tax credit. The bill also (1) alters the program by specifying that the investor who makes the qualifying investment in a Maryland cybersecurity company claims the tax credit instead of the cybersecurity company and (2) alters specified eligibility requirements.

The bill also creates a tax credit against the State income tax for a qualified buyer who purchases cybersecurity technology or service from a Maryland company that meets specified requirements. The amount of the credit is equal to 50% of the qualified cost, not to exceed \$50,000 for each qualified buyer. The Department of Commerce (Commerce) must administer the program and may approve a specified maximum amount of tax credits in each year. **The bill takes effect June 1, 2018, and applies to tax credit certificates issued after June 30, 2018.**

Fiscal Summary

State Effect: General fund revenues decrease by \$2.0 million in FY 2019 due to the tax credit established by the bill. General fund expenditures increase by \$72,800 in FY 2019 due to implementation costs at Commerce. Future year expenditures reflect ongoing expenses and mandated appropriations to the program. **This bill extends a mandated appropriation beginning in FY 2020.**

(\$ in millions)	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
GF Revenue	(\$2.0)	(\$4.0)	(\$4.0)	(\$4.0)	(\$4.0)
GF Expenditure	\$0.1	\$2.1	\$2.1	\$2.1	\$2.1
Net Effect	(\$2.1)	(\$6.1)	(\$6.1)	(\$6.1)	(\$6.1)

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

Local Effect: Local highway user revenues decrease as a result of any credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary:

Existing Cybersecurity Incentive Tax Credit

Under current law, a qualifying investment does not include debt. The bill specifies that an investment includes convertible debt.

The bill also alters the eligibility of a qualified cybersecurity company by (1) eliminating the time period limitation that prohibits a qualified company from being eligible for the tax credit if the company has been in active business for more than five years and (2) specifying that a cybersecurity company includes an entity that becomes duly organized and existing under the laws of any jurisdiction for the purpose of conducting business for profit within four months of receiving a qualified investment and provides for recapture of the credit if the entity does not satisfy this requirement.

New Credit for the Purchase of Qualified Cybersecurity Technology or Service

The bill creates a tax credit against the State income tax for qualified buyers who purchase cybersecurity technology or service from a cybersecurity business. The purchase must be made from a cybersecurity company that meets specified criteria, including requirements that the company (1) has its headquarters and base of operations in the State; (2) has less than \$5.0 million in annual revenue; (3) is a minority-owned, woman-owned, veteran-owned, or service-disabled veteran-owned business or is located in a historically underutilized business zone designated by the United States Small Business Administration; and (4) owns or has properly licensed any proprietary technology or provides cybersecurity service. A qualified buyer is any entity that has less than 50 employees in the State and is required to file a State income tax return.

Commerce, in consultation with the Maryland Technology Development Corporation, may establish a panel composed of experts in the area of cybersecurity technology and service in order to assist Commerce in determining if a cybersecurity company meets the bill's requirements.

The Secretary of Commerce may approve a total of \$2.0 million in tax credits in tax year 2018 and \$4.0 million annually beginning in tax year 2019. The Secretary of Commerce must award 25% of the total tax credits awarded in each year to qualified buyers that purchase cybersecurity services.

A qualified buyer may claim an income tax credit equal to 50% of the cost incurred to purchase cybersecurity technology or service from a qualified cybersecurity company. The credit may not exceed \$50,000 for each qualified buyer. Commerce may not certify purchases from a single cybersecurity company that total more than \$200,000 in a tax year. Commerce must annually report specified information about the program.

The bill establishes the procedures for claiming the credit and a process for revoking the credit if program requirements are not met. Commerce and the Comptroller must jointly adopt regulations to implement the tax credit application, approval, and monitoring processes.

Tax Credit Evaluation Committee

The bill requires the Tax Credit Evaluation Committee to evaluate by July 1, 2023, the cybersecurity investment incentive and purchase of cybersecurity technology or service tax credits.

Current Law: Chapter 390 of 2013 established a refundable tax credit for investments in qualified cybersecurity companies. Commerce administers the tax credit application, approval, and certification process and is required to submit a report to the Governor and the General Assembly detailing specified information about the tax credit each year. The Governor is required to appropriate at least \$2 million to the reserve fund in each fiscal year. The fiscal 2019 State budget includes \$2.0 million in funding for the program.

A qualified Maryland cybersecurity company can claim a credit equal to 33% of a qualified investment, not to exceed \$250,000. Chapter 504 of 2016 increased the value of the tax credit if the qualified cybersecurity company in which an investment is made is located in Allegany, Dorchester, Garrett, or Somerset counties. The value of the credit for investments made in these companies is equal to 50% of the investment, not to exceed \$500,000.

A cybersecurity company is a company organized for profit that is primarily engaged in the development of innovative and proprietary cybersecurity technology. A company is any entity of any form duly organized and existing under the laws of any jurisdiction for the purpose of conducting business for profit. A company does not include a sole proprietorship.

A qualifying company must meet specified criteria, including requirements that the company (1) has been in business for no more than five years; (2) has less than 50 full-time employees; (3) has its headquarters and base of operations in Maryland; (4) is not publicly traded on any exchange; (5) has not participated in the tax credit program for more than one prior fiscal year; (6) owns or has properly licensed any proprietary technology; and (7) has an aggregate capitalization of at least \$100,000.

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 Cybersecurity Investment Tax Credit Reserve Fund in that year. Commerce may not certify investments in a single cybersecurity company that total more than 15% of the total appropriations to the reserve fund for that fiscal year. Tax credit applications are approved on a first-come, first-served basis until the total cap for the year is reached.

Background: As shown in **Exhibit 1**, Commerce has certified a total of \$2.7 million in tax credits to 10 companies. Most of these companies are located in Baltimore City and Montgomery County.

Exhibit 1
Cybersecurity Investment Incentive Tax Credits
Fiscal 2014-2017

<u>Fiscal Year</u>	<u>Companies</u>	<u>Final Credits</u>
2014	3	\$996,050
2015	2	575,425
2016	3	900,425
2017	2	268,890
Total	10	\$2,740,790

Note: Fiscal 2017 reflects final credits issued as of December 31, 2016.

Source: Department of Commerce

The Montgomery County Cybersecurity Tax Credit Supplement Program provides additional funds to cybersecurity companies that receive a State tax credit and have their headquarters and base of operations in Montgomery County. The credit is equal to 50% of the State credit received, not to exceed 15% of the amount appropriated to the Montgomery County program. Montgomery County provided \$483,000 to the program for fiscal 2017 and has awarded funds to two companies as of February 2017.

State Revenues: The bill creates an income tax credit for qualified buyers who purchase specified cybersecurity technology or service and authorizes Commerce to award a specified amount of credits in each tax year. As a result, general fund revenues will decrease by \$2.0 million in fiscal 2019 and by \$4.0 million annually beginning in fiscal 2020.

This estimated revenue impact assumes that the maximum amount of authorized credits are awarded in each year and are claimed against the personal income tax. To the extent Commerce does not award the maximum amount, revenue losses will be less than estimated. A portion of credits claimed will decrease Transportation Trust Fund and Higher Education Investment Fund revenues if credits are claimed against the corporate income tax.

State Expenditures:

Program Appropriations

The bill extends the termination date of the program to June 30, 2023. Assuming the program is funded at this level, general fund expenditures will increase by \$2.0 million annually in fiscal 2020 through 2023. However, there is no limit on the amount that can be appropriated to the reserve fund. To the extent that the Governor provides more money to the reserve fund in any year, the increase in general fund expenditures will be greater. **Appendix 1** shows the net impact of the bill.

Administrative Costs

The Department of Legislative Services (DLS) estimates that Commerce will need one program administrator to implement the additional tax credit. As a result, general fund expenditures for Commerce will increase by \$72,800 in fiscal 2019. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	1
Salary and Fringe Benefits	\$67,235
Operating Expenses	5,515
Total FY 2019 Expenditures	\$72,750

Future year expenditures reflect annual increases and employee turnover and ongoing operating expenses.

Small Business Effect: The tax credit program requires a qualified cybersecurity company to have less than 50 full-time employees. Accordingly, the proposed extension and changes to the program allowing an investor to claim the credit will positively impact small

businesses that receive investments under the program; however, it is expected that a limited number of businesses will benefit.

Small businesses that sell and purchase cybersecurity technology and services may benefit from the subsidy provided for the purchase of qualified technology and services. DLS notes that there is likely significant overlap with these companies and existing State programs, including the cybersecurity investment incentive tax credit.

Additional Information

Prior Introductions: SB 318 of 2017, a similar bill, received a favorable with amendments report from the Senate Budget and Taxation Committee, passed the Senate, and received a hearing in the House Ways and Means Committee, but no further action was taken. Its cross file, HB 378, received a hearing in the House Ways and Means Committee, but no further action was taken.

Cross File: None.

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

Appendix 1 – Fiscal Impact of Legislation Fiscal 2019-2023

	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>
<u>General Fund Expenditures</u>					
Reserve Fund Appropriation	\$0	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
Administrative Expenses	72,750	68,297	70,312	72,855	75,491
Total	\$72,750	\$2,068,297	\$2,070,312	\$2,072,855	\$2,075,491
<u>General Fund Revenues</u>					
Tax Credit Claims	(\$2,000,000)	(\$4,000,000)	(\$4,000,000)	(\$4,000,000)	(\$4,000,000)
Net Effect	(\$2,072,750)	(\$6,068,297)	(\$6,070,312)	(\$6,072,855)	(\$6,075,491)