

Department of Legislative Services
 Maryland General Assembly
 2019 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 886
 Ways and Means

(Delegate Palakovich Carr, *et al.*)

Income Tax - Angel Investor Tax Credit Program

This bill creates a tax credit against the State income tax for investors that make qualified investments in Maryland innovation businesses. The credit is equal to 50% of the qualified investment if the qualified innovation business is located in Baltimore City or Anne Arundel, Baltimore, Howard, Montgomery, or Prince George’s counties or 67% of the qualified investment if the business is located elsewhere. The credit may not exceed \$50,000 for an individual or \$100,000 for married couples that file a joint return or a pass-through entity. The taxpayer can carry forward any unused credit for up to four succeeding tax years. The amount of credits that the Department of Commerce (Commerce) can award each year cannot exceed the amount of money appropriated to a reserve fund established by the bill. The bill also requires the Maryland Department of Transportation (MDOT) to conduct a disparity study and report its findings to the General Assembly by December 1, 2019. **The bill takes effect July 1, 2019, and applies to tax years 2019 through 2022. The bill terminates on June 30, 2024.**

Fiscal Summary

State Effect: If the credit is funded at \$5.0 million, general fund expenditures increase by \$5.0 million in FY 2020 through 2023. Administrative costs increase by \$1.1 million in FY 2020 with ongoing costs through FY 2023. Revenues are not affected.

(\$ in millions)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	5.1	5.1	5.1	5.0	0
SF Expenditure	1.1	0.5	0	0	0
Net Effect	(\$6.1)	(\$5.5)	(\$5.1)	(\$5.0)	\$0.0

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

Local Effect: None.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill establishes a Maryland Angel Investor Tax Credit Reserve Fund. The total amount of tax credit certificates issued by Commerce in each fiscal year cannot exceed the amount appropriated to the reserve fund in the State budget. It is the General Assembly's intent that the Governor appropriate at least \$5.0 million to the reserve fund in each year. Any amount of money in the fund that is not expended in the fiscal year is rolled over into the next fiscal year.

The credit is claimed by an accredited investor, as defined by the federal Securities and Exchange Commission, who (1) meets the qualifications of the bill; (2) follows the application and certification process established by the bill; and (3) invests in a qualified innovation business that is certified by Commerce.

Commerce may not certify investments in a single qualified innovation business that total more than 15% of the total appropriations to the reserve fund for that fiscal year. An eligible investment is defined as an at-risk investment of at least \$10,000 (\$20,000 for a pass-through entity or joint filer) in exchange for stock, convertible debt, or ownership interest. An investor may not acquire an ownership interest in a company that exceeds 20% and must submit an application to Commerce.

A qualified innovation business is defined as a for-profit entity in a specified industry that has or is in the process of developing a technology, product, or service that is unique and legally owned or licensed by the business. A qualified innovation business does not include a qualified biotechnology company or a qualified cybersecurity company. A qualified innovation business must be in good standing as determined by the State Department of Assessments and Taxation (SDAT) and meet specified criteria, including requirements that the company (1) does not have annual revenue of more than \$1 million; (2) has been in business for no more than five years; (3) has not received more than \$3 million in investments; (4) has less than 15 full-time employees; (5) has its headquarters and base of operations in Maryland; (6) is not publicly traded on any exchange; and (7) has at least 51% of its full-time equivalent employees employed in the State and at least 51% of its payroll paid to the employees in the State.

The bill specifies how Commerce can issue initial tax credit certificates by each quarter of the fiscal year. Tax credit applications are approved on a first-come, first-served basis until the total cap for the year is reached. The bill provides for the circumstances under which the credit may be rescinded, revoked, or recaptured.

Commerce is required to (1) approve tax credit applications; (2) determine the eligibility of qualified innovation businesses and investors; and (3) adopt regulations, in consultation with the Comptroller, to implement the credit. Additionally, the bill adds the tax credit to

the list of economic development programs that Commerce must report on to the Governor and the General Assembly each year.

The certification agency within MDOT, in consultation with Commerce and the Office of the Attorney General, must initiate a study of specified innovative industries to determine whether there is a compelling interest to implement remedial measures to assist minorities and women in those industries. The certification agency must evaluate race-neutral programs or other methods that may be used to address the needs of minority and women businesses in those industries and minority and women entrepreneurs seeking to participate in those industries.

Current Law: Chapter 99 of 2005 established the biotechnology investment tax credit, which offers a similar refundable budgeted tax credit for investments in qualified biotechnology 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. An investor who invests at least \$25,000 in a qualified Maryland biotechnology company can claim a credit equal to 50% of the investment, not to exceed \$250,000. If the qualified biotechnology company is located in Allegany, Dorchester, Garrett, or Somerset counties, the value of the credit for investments made in these companies is equal to 75% of the investment, not to exceed \$500,000. Commerce may not certify investments in a single biotechnology company that total more than 15% of the total appropriations to the reserve fund for that fiscal year. Pursuant to the Tax Credit Evaluation Act, the Department of Legislative Services (DLS) evaluated the biotechnology investment tax credit and made several recommendations in a [report](#) issued in October 2018.

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. A qualified investor can claim a credit equal to 33% of a qualified investment, not to exceed \$250,000. A qualified investment is an at-risk investment of at least \$25,000 in exchange for stock or ownership interest. 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.

Maryland's Minority Business Enterprise Program

The State's Minority Business Enterprise (MBE) program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Office of Small, Minority, and Women Business Affairs,

in consultation with the Secretary of Transportation and the Attorney General. Generally, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting. Each industry is composed of specific industry classifications defined by U.S. Census North American Industry Classification System codes.

The most recent disparity study was completed in 2017 and serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland.

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

Background: Federal law defines an accredited investor as a person who:

- earned income that exceeded \$200,000 (or \$300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year;
- has a net worth over \$1 million, either alone or together with a spouse (excluding the value of the person's primary residence); or
- is the director, executive officer, or general partner of the issuer (or the general partner of that issuer) of the securities being offered or sold.

In addition, entities such as banks, partnerships, corporations, nonprofits, and trusts may be accredited investors.

Investment Tax Credits in Other States

A majority of states have established programs that provide income tax credits for investing in early-stage technology companies. These programs are commonly referred to as investment tax credit programs. Maine established the first program in 1998. Prior to 2005, there were a limited number of state programs; however, about one-half of all states have some type of program as of July 2017, as shown in **Exhibit 1**. Angel investor programs vary according to the value of the credit, restrictions on the investments and companies that qualify, and other program requirements. Unlike Maryland's biotechnology investment incentive tax credit, programs in other states are not typically limited to

Governor provides more than \$5.0 million to the reserve fund in any year, the increase in general fund expenditures will be greater.

Revenue Impacts

Within 15 days after the end of each calendar quarter, Commerce is required to notify the Comptroller of the total amount of final credit certificates that were issued during the quarter. Upon this notification, the Comptroller is required to transfer from the reserve fund to the general fund the total amounts stated in the final credit certificates that were issued during the quarter.

It is assumed that taxpayers claim the credit in the tax year that corresponds to the fiscal year in which the Comptroller transfers funds to the general fund on notification of a certified credit. To the extent that taxpayers claim the credit or adjust estimated quarterly payments or withholdings in a different fiscal year from when the transfer is made, general fund revenues could increase in these fiscal years and potentially decrease by a corresponding amount in later fiscal years. This timing issue, however, does not alter the total overall cost of the bill.

Administrative Expenditures

General fund expenditures increase by \$1.1 million in fiscal 2020 due to implementation costs at Commerce, MDOT, and the Comptroller's Office, as described below. SDAT can issue letters of good standing for qualified innovation businesses with existing resources.

As MDOT is the State's certification agency, it is responsible for carrying out the study specified in the bill. The bill lists nine industries to be included in the study, of which information technology is the only industry that the State has the relevant contract, subcontract, and firm data required for a disparity analysis. The most recent statewide MBE study conducted by MDOT took two years to complete and used an outside consultant to analyze seven industries, at a cost of approximately \$1.5 million. The bill requires the study to be completed by December 1, 2019, but MDOT advises that the study would take two years to complete. Thus, Transportation Trust Fund expenditures by MDOT increase by \$1.05 million in fiscal 2020 and by \$450,000 in fiscal 2021 to complete the disparity study.

The Comptroller's Office reports it will incur a one-time expenditure increase of \$34,000 in fiscal 2020 to add the credit to the personal income tax form. This amount includes data processing changes to the income tax return processing and imaging systems and systems testing.

Commerce indicates it would need one tax credit specialist to administer the program. However, DLS advises that the added responsibilities incurred by this legislation are not permanent and could be performed by a contractual employee. General fund expenditures increase by an estimated \$63,111 in fiscal 2020, which reflects the bill's July 1, 2019 effective date. This estimate includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Contractual Position	1
Salary and Fringe Benefits	\$57,596
Other Operating Expenses	<u>5,515</u>
Commerce Expenditures	\$63,111
MDOT Expenditures	1,050,000
Comptroller Expenditures	<u>34,000</u>
Total FY 2020 Expenditures	\$1,147,111

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

This estimate does not include any health insurance costs that could be incurred for specified contractual employees under the State's implementation of the federal Patient Protection and Affordable Care Act.

Small Business Effect: Small businesses that are pass-through entities and make qualified investments in a qualified innovation business may benefit by claiming a tax credit against the individual income tax of up to \$100,000 in fiscal 2020 through 2023. Qualified innovation businesses that have developed or are in the process of developing a technology, product, or service that is unique and legally owned or licensed by the business may benefit by increased investments from qualified investors.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Montgomery and Prince George's counties; Office of the Attorney General; Department of Commerce; Comptroller's Office; Maryland Department of Transportation; Department of Legislative Services

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