

Department of Legislative Services
Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 565

Ways and Means

(Delegate Kaiser, *et al.*)

Budget and Taxation

Income Tax – Business and Economic Development Tax Credits – Termination, Alteration, and Evaluation

This bill alters the following tax credit programs: (1) enterprise zone; (2) Regional Institution Strategic Enterprise Zone (RISE); (3) More Jobs for Marylanders; (4) research and development (R&D); and (5) biotechnology investment incentive. The bill accelerates the termination dates of the cybersecurity investment incentive and employer security clearance costs tax credit programs. In addition, the bill expands the scope of the Tax Credit Evaluation Act to include tax exemptions and preferences and alters certain procedures under the Act. **The bill generally takes effect June 1, 2020.**

Fiscal Summary

State Effect: State revenues increase by \$2.0 million in FY 2021 and by \$0.5 million in FY 2024 due to the termination of specified tax credits. General fund expenditures for More Jobs for Marylanders and cybersecurity investment incentive tax credit appropriations decrease by \$5.0 million in FY 2021 and by \$10.0 million in FY 2025. Transportation Trust Fund expenditures increase minimally in FY 2022 through 2024 due to additional corporate income tax revenues.

(\$ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	\$2.0	\$3.4	\$0.4	\$0.4	\$0
SF Revenue	\$0	\$0.3	\$0.1	\$0.1	\$0
GF Expenditure	(\$5.0)	(\$12.0)	(\$12.0)	(\$10.0)	(\$10.0)
SF Expenditure	\$0	\$0.0	\$0.0	\$0.0	\$0
Net Effect	\$7.0	\$15.7	\$12.5	\$10.4	\$10.0

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

Local Effect: Local highway user revenues will increase minimally in fiscal 2022 through 2024 due to a reduction in tax credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary:

More Jobs for Marylanders Program

Under the More Jobs for Marylanders Program, a qualified business can receive program benefits – a State income tax credit, State sales and use tax exemption, corporate filing fee waiver, and State property tax credit – for up to ten consecutive benefit years. The Department of Commerce (Commerce) is authorized in fiscal 2021 and 2022 to award an annual maximum of \$9.0 million in income tax credits and \$1.0 million in sales tax exemptions. The bill specifies that business entities enrolling in the program after July 1, 2020 may only claim up to 5 consecutive benefit years and do not qualify for the sales tax exemption. The bill reduces, to \$5.0 million, the annual maximum amount of authorized income tax credits.

R&D Tax Credit

The bill repeals the basic credit and increases from \$6.5 million to \$9.0 million the total amount of growth credits that Commerce may award. A business may not receive greater than 5% of the total tax credits awarded in the tax year.

Under current law, a business that meets certain requirements, including net book value assets totaling less than \$5.0 million, can claim a refundable tax credit. The bill defines net book value assets as the total of a business's net value of assets, including intangibles but not including liabilities, minus depreciation and amortization. Commerce must set aside 30% of the total tax credits awarded annually to qualified small businesses.

Cybersecurity Investment Incentive and Employer Security Clearance Tax Credits

The bill accelerates, by two years, the termination dates of the cybersecurity investment incentive and employer security clearance costs tax credit programs. Tax credits may be claimed through tax year 2020 (cybersecurity) and tax year 2019 (employer security clearance).

Enterprise and RISE Zones

The Secretary of Commerce may not designate or expand an enterprise zone or focus area from July 1, 2020, through June 30, 2021. In addition, under current law, any area designated under federal law as an enterprise zone, empowerment zone, or enterprise community is automatically designated as a State enterprise zone. This provision is eliminated during the specified one-year period. The Secretary of Commerce may not designate or renew a RISE zone during this specified one-year period.

Biotechnology Investment Incentive Tax Credit

Under current law, a qualified Maryland biotechnology company may participate in the program if it meets certain requirements, including limitations on the number of years the company has been in operations. The bill repeals this limitation and instead specifies that a company may not participate in the program if its investors have received greater than \$6.0 million in cumulative program tax credits.

Tax Credit Evaluation Act

The bill alters the Tax Credit Evaluation Act, which established a legislative process providing for the review of State tax credits, by eliminating the Tax Credit Evaluation Committee. The Department of Legislative Services (DLS) must evaluate a tax credit, exemption, or preference on request from the Senate Budget and Taxation Committee, House Ways and Means Committee, Executive Director of DLS, or Director of the Office of Policy Analysis of DLS.

Commerce Reporting

Commerce, in consultation with qualified experts in the biotechnology and cybersecurity industries, must study the methods and criteria by which the department could competitively award the biotechnology investment incentive, cybersecurity investment incentive, and R&D tax credits. Commerce must report to the General Assembly its findings and recommendations by December 1, 2020.

Current Law/Background:

More Jobs for Marylanders Program

The More Jobs for Marylanders Program, administered by Commerce, provides State income tax, sales tax, property tax, and fee benefits to certain businesses that create and maintain a minimum number of qualified jobs. Eligibility for specific benefits is determined by the type of business, its location, and whether or not it is a new business. Generally, a business must operate or conduct a trade or business that is primarily engaged in manufacturing, or else be located in an Opportunity Zone, and not be otherwise excluded by law. A business within a “Tier I Area” must create at least 5 qualified positions, and a business within a “Tier II Area” must create at least 10 qualified positions – there are different requirements for both areas. Specific benefits are as follows:

- *Tier I New Manufacturing Business:* (1) a refundable credit against the State income tax of 5.75% of wages for each qualified position; (2) a credit against the State’s

portion of the property tax; (3) a refund of sales and use tax; and (4) a waiver of the annual corporate filing fee.

- *Tier I or Tier II Existing Manufacturing Business:* A refundable credit against the State income tax of 5.75% of wages for each qualified position.
- *Opportunity Zone New Non-manufacturing Business:* (1) a refundable credit against the State income tax of 5.75% of wages for each qualified position; (2) a credit against the State's portion of the property tax that is the lesser of 100% of the State property tax *or* \$250 per qualified position; (3) a refund of sales and use tax; and (4) a waiver of the annual corporate filing fee.
- *Opportunity Zone Existing Non-manufacturing Business:* A refundable credit against the State income tax of 5.75% of wages for each qualified position.

Businesses excluded from program eligibility are (1) refiners; (2) those that provide adult entertainment; (3) those that engage in retail activities, except for grocery stores located in Opportunity Zones; and (4) those primarily engaged in the sale or distribution of alcoholic beverages.

Tier I Areas include Baltimore City and Allegany, Baltimore, Caroline, Cecil, Dorchester, Garrett, Kent, Prince George's, Somerset, Washington, Wicomico, and Worcester counties. Tier I Areas also include Opportunity Zones located in *any* Maryland county. Tier II Areas are any areas that are not Tier I Areas. Counties must meet specified income or unemployment criteria, or be designated by Commerce, to be considered a Tier I Area. Opportunity Zones are census tracts designated by the State as part of a federal program established by the Federal Tax Cuts and Jobs Act of 2017.

Commerce may certify businesses as eligible for the program through June 1, 2022. Commerce may annually award up to \$9.0 million in credits against the State income tax and up to \$1.0 million in sales and use tax refunds. If other requirements continue to be met, a business is eligible for 10 consecutive years of benefits. The Governor must appropriate sufficient funds to two related reserve accounts each year, subject to specified requirements. Therefore, each program certification year creates up to \$100 million in future amounts that must be appropriated to reserve funds through the annual budget process. State property tax credits and corporate filing fee exemptions are unlimited.

In addition to providing tax benefits to businesses that meet program requirements and are certified by Commerce, the program also allows a manufacturer located in the State to claim increased expensing amounts under the State income tax by conforming State law to the maximum aggregate costs of expensing allowed under Section 179 of the Internal Revenue Code (IRC) and to claim any bonus depreciation amounts provided under HB 565/ Page 4

Section 168(k) of IRC. These benefits apply if the property was placed in service on or after January 1, 2019.

R&D Tax Credit

Chapters 515 and 516 of 2000 established the State R&D Tax Credit Program. There are two types of credits available: (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. Through tax year 2020, Commerce may award \$12.0 million in aggregate tax credits – \$5.5 million in basic credits and \$6.5 million in growth credits.

Except for certain businesses, the tax credit is nonrefundable – the value of the credit may not exceed the tax liability imposed in the tax year. Any unused amount of the credit may be carried forward for seven years after the taxable year in which the expense was incurred. Chapter 109 of 2013 made the R&D credit refundable if the business meets the qualifications of a small business beginning in tax year 2012. The tax credit is 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 assets totaling less than \$5 million.

Cybersecurity Investment Incentive

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. The Governor is required to appropriate at least \$2 million to the reserve fund in each fiscal year. Chapter 578 of 2018 extended through fiscal 2023 the termination date of the tax credit and altered 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.

Employer Security Clearance Costs

The employer security clearance costs tax credit program allows a State income tax credit for certain security clearance administrative expenses and for the construction and equipment costs to construct or renovate a sensitive compartmented information facility located in the State. An annual maximum of \$2.0 million in tax credits may be awarded through tax year 2021.

Enterprise Zones

The enterprise zone tax credit program, established in 1982, is intended to encourage economic growth within economically distressed areas of the State and to increase employment of the chronically unemployed. Businesses located within an enterprise zone are eligible for local property tax credits and State income tax credits. Real property tax credits are 10-year credits against local real property taxes on a portion of the qualifying real property improvements in the enterprise zone. The income tax credit is based on wages paid to newly hired employees and can be taken over a 1- to 3-year period. The credits are based on the wages paid during the taxable year to each qualified employee and vary in value and length of time depending on whether the employee is certified by the Maryland Department of Labor as being economically disadvantaged and if the business is located in a focus area.

The Secretary of Commerce may designate one or more State enterprise zones within 60 days of a political subdivision's submission for an enterprise zone designation. Once approved, the enterprise zone designation is effective for 10 years. At any time, a political subdivision may reapply to the Secretary to designate another area as an enterprise zone. The Secretary of Commerce may designate annually six enterprise zones and one extraordinary expansion. A county may not receive more than two enterprise zone designations in a calendar year.

Chapter 173 of 2006 granted the Secretary the authority to approve the expansion of an existing enterprise zone by up to 50% in size without the expansion counting toward the statutory limit. Pursuant to Chapter 362 of 2006, any business located in a State enterprise zone may apply for the tax credit for an additional five years following the zone's expiration.

The State Department of Assessments and Taxation reimburses local governments (through the department's annual general fund budget) for 50% of the property tax revenue decrease that results from the property tax credit.

In calendar 2019, there were 37 State enterprise zones comprising a total area of about 86,000 acres. In recent years, the program has increased by an average of 1,000 acres in each year. The fiscal 2021 operating budget includes \$26.2 million in local property tax reimbursements. In recent years, an average of about \$1.0 million in income tax credits have been claimed.

RISE Zones

Chapters 530 and 531 of 2014 established the RISE Zone Program. The program aims to promote economic and community development within communities anchored around a

qualified institution. Qualified institutions include institutions of higher education (public and private four-year institutions and community colleges), nonprofit organizations affiliated with federal agencies, and regional higher education centers.

Businesses within a zone can qualify for an employment tax credit and a property tax credit for certain capital investments made within the zone.

Commerce advises that six RISE zones have been designated, but no credits have been awarded under the program as of January 2020.

Biotechnology Investment Incentive

Chapter 99 of 2005 established the biotechnology investment incentive tax credit program, which offers a refundable income tax credit for investments in qualified biotechnology companies. 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 administers the tax credit application process and 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. The total amount awarded in each year is generally limited to the amount appropriated to the program.

The fiscal 2021 operating budget includes \$12.0 million in funding for the program.

Recent Program Evaluations and Audits

Pursuant to the Tax Credit Evaluation Act, DLS has evaluated the enterprise zone, RISE zone, biotechnology investment incentive, and R&D tax credit programs. The [evaluations](#) of the tax credit programs can be found on the DLS website.

In September 2019, the Office of Legislative Audits issued a fiscal compliance audit of Commerce. A copy of the audit, and its findings related to the biotechnology investment incentive tax credit, can be found on the DLS [website](#).

State Fiscal Effect: The bill accelerates the termination dates of the cybersecurity investment incentive and employer security clearance costs tax credit programs and alters the following tax credit programs: (1) enterprise zone; (2) RISE zone; (3) biotechnology investment incentive; (4) More Jobs for Marylanders; and (5) R&D. **Exhibits 1** and **2** detail the estimated impact of the bill on State finances.

Exhibit 1
State Fiscal Impact by Program
Fiscal 2021-2025

<u>Program</u>	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
More Jobs for Marylanders	\$5.0	\$10.0	\$10.0	\$10.0	\$10.0
R&D	0.0	1.8	0.6	0.4	0.0
Cybersecurity Investment	0.0	2.0	2.0	0.0	0.0
Employer Security Clearance	2.0	2.0	0.0	0.0	0.0
Total	\$7.0	\$15.8	\$12.6	\$10.4	\$10.0

R&D: research and development

Exhibit 2
State Fiscal Impact by Fund
Fiscal 2021-2025

	<u>FY 2021</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
Revenues					
General Fund	\$2,000,000	\$3,420,000	\$444,000	\$355,000	\$0
TTF	0	244,000	76,000	61,000	0
HEIF	0	100,000	31,000	25,000	0
Total Revenues	\$2,000,000	\$3,764,000	\$551,000	\$441,000	\$0
Expenditures					
General Fund	(\$5,000,000)	(\$12,000,000)	(\$12,000,000)	(\$10,000,000)	(\$10,000,000)
TTF	0	33,000	10,000	8,000	0
Total Expenditures	(\$5,000,000)	(\$11,967,000)	(\$11,990,000)	(\$9,992,000)	(\$10,000,000)
Net Impact	\$7,000,000	\$15,731,000	\$12,541,000	\$10,433,000	\$10,000,000

HEIF: Higher Education Investment Fund

TTF: Transportation Trust Fund

The estimated fiscal impacts for the More Jobs for Marylanders, employer security clearance, cybersecurity investment incentive, and R&D tax credit programs assume that

the maximum amount of tax credits will be awarded in each year. To the extent the maximum amount of credits would not be awarded, the net impact on State finances will be less than estimated.

Altering the More Jobs for Marylanders Program is projected to decrease general fund expenditures by a total of \$150.0 million in fiscal 2021 through 2031. State revenues will also increase due to a reduction in corporate filing fee waivers and State property tax credit claims.

The bill's provisions related to the enterprise zone, RISE zone, and biotechnology investment incentive tax credit programs are not expected to materially impact State finances in fiscal 2021 through 2025.

Local Revenues: Local highway user revenues will increase minimally in fiscal 2022 through 2024 due to a reduction in tax credits claimed against the corporate income tax.

Small Business Effect: Small businesses that will not receive tax credits or investments under the altered or terminated programs will be negatively impacted. Other small businesses may benefit from the reallocation of biotechnology investment incentive and R&D tax credits.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Department of Commerce; Comptroller's Office; State Department of Assessments and Taxation; Department of Legislative Services

Fiscal Note History: First Reader - February 11, 2020

rh/jrb Third Reader - May 4, 2020

Revised - Amendment(s) - May 4, 2020

Analysis by: Robert J. Rehrmann

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