

Department of Legislative Services
Maryland General Assembly
2024 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 1294
Ways and Means

(Delegate Young)

Artificial Intelligence Tools - Income Tax Credit and Sales and Use Tax

This bill (1) prohibits the Secretary of Commerce from issuing tax credit certificates for the purchase of cybersecurity technology or services (Purchase Cybersecurity Tax Credit Program) after tax year 2023 and (2) for tax years 2024 through 2026 only, allows an income tax credit for up to \$50 of costs paid or incurred during the tax year for the use of artificial intelligence (AI) tools, subject to specified application and documentation requirements. Similar to the existing credit for the purchase of cybersecurity technology or services, the tax credit is to be administered by the Department of Commerce, and the Secretary may approve up to \$4.0 million in credit certificates annually. Lastly, the bill specifies that “digital product” as it applies to the State sales and use tax includes AI tools. **The bill takes effect July 1, 2024. Provisions relating to the income tax credit for AI tools apply to tax years 2024 through 2026 and terminate June 30, 2027.**

Fiscal Summary

State Effect: In FY 2025 through 2027, general fund revenues potentially decrease or increase to the extent the tax credit established under the bill is utilized to a greater or lesser extent than the existing Purchase Cybersecurity Tax Credit Program, as discussed below. Beginning in FY 2028, general fund revenues increase by an estimated \$400,000 annually, reflecting the termination of the authority to issue Purchase Cybersecurity Tax Credit certificates. Higher Education Investment Fund revenues and Transportation Trust Fund revenues and expenditures may be minimally affected to the extent the bill affects the amount of credits claimed against the corporate income tax.

Local Effect: Local highway user revenues may be minimally affected to the extent the bill affects the amount of credits claimed against the corporate income tax. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: “AI tool” means software or software as a service that utilizes AI (within the meaning of 15 U.S.C. § 9401(3) (National AI Initiative)) for various purposes, including data analysis, automation, and machine learning. “Qualified buyer” means a resident of the State or a business entity.

The purpose of the credit is to foster technological advancement, improve productivity, and encourage digital literacy and innovation within the State by making AI tools more financially accessible and thereby encouraging residents and businesses to increase their digital literacy and utilization of AI tools.

Commerce must adopt regulations to implement the tax credit program and report specified information relating to the utilization of the program.

Current Law:

Purchase Cybersecurity Tax Credit

Chapter 578 of 2018 established a credit against the State income tax for costs incurred by qualified buyers (defined as any entity that has fewer than 50 employees in the State and is required to file a Maryland income tax return) to purchase cybersecurity technology or services from a qualified seller. The value of the credit is equal to 50% of the eligible costs incurred, not to exceed \$50,000 per qualified buyer.

For purposes of the credit, “qualified seller” is defined as a cybersecurity business that (1) has its headquarters and base of operations in the State; (2) has less than \$5.0 million in annual revenue, 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 U.S. Small Business Administration; and (3) owns or has properly licensed any proprietary cybersecurity technology or provides a cybersecurity service (among other specified requirements).

The Secretary of Commerce may approve up to \$4.0 million in tax credit certificates annually and must award 25% of the amount of authorized tax credits to qualified buyers that purchase cybersecurity services.

In accordance with the Tax Expenditure Evaluation Act, the Department of Legislative Services (DLS) evaluated the Purchase Cybersecurity Tax Credit Program during the

2023 interim and made several findings and recommendations as outlined in its December 2023 [report](#). Among other things, DLS found that the tax credit program is underutilized and recommended that the General Assembly consider terminating the program and exploring alternative options, such as grants, to improve cybersecurity in the State for small businesses.

Treatment of Digital Products under State Sales and Use Tax

Chapter 38 of 2021, as amended by Chapters 33, 534, and 535 of 2022, imposed the State sales and use tax on specified digital products and codes. “Digital product” means a product that is obtained electronically by the buyer or delivered by means other than tangible storage media through the use of technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. Section 11-101 of the Tax-General Article further specifies products that are included in and excluded from the definition of “digital product” as it applies to the sales and use tax.

State Revenues: As discussed above, the bill prohibits the issuance of credit certificates under the Purchase Cybersecurity Tax Credit Program after tax year 2023 and, for tax years 2024 through 2026 only, establishes a tax credit for up to \$50 of costs paid or incurred during the tax year for the use of AI tools. Consistent with the existing Purchase Cybersecurity Tax Credit, under the bill, Commerce may approve up to \$4.0 million in credit certificates annually in tax years 2024 through 2026.

While the bill does not alter the aggregate amount of credit certificates that Commerce may award in tax years 2024 through 2026, general fund revenues are potentially affected in fiscal 2025 through 2027 to the extent that the tax credit program established under the bill is utilized to a greater or lesser extent than the existing Purchase Cybersecurity Tax Credit. On average, Commerce has awarded a little over \$400,000 in credit certificates annually under the Purchase Cybersecurity Tax Credit Program – well below the annual maximum authorized amount of \$4.0 million for tax years after 2018. While it is unknown how many taxpayers will apply for and claim credits under the bill for costs paid or incurred for the use of AI tools, given the limited value of the credit, DLS does not expect a significant volume of claims.

Beginning in fiscal 2028 – after the termination of the credit for AI tools – general fund revenues increase by an estimated \$400,000 annually, reflecting the permanent termination of the issuance of Purchase Cybersecurity Tax Credit certificates. This estimate is based on the average historical utilization of the credit.

It is assumed that the bill’s alteration to the definition of a digital product for purposes of the sales and use tax is generally clarifying in nature and thus is not expected to affect State revenues. However, to the extent that AI tools, as defined under the bill, are not currently

subject to the sales and use tax, general fund and Blueprint for Maryland's Future Fund revenues may increase beginning in fiscal 2025.

Additional Information

Recent Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: None.

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

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km/jrb

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