



Larry Hogan | Governor
Boyd Rutherford | Lt. Governor
Kelly M. Schulz | Secretary of Commerce

DATE: April 1, 2021 **COMMITTEE:** House Ways and Means
BILL NO: Senate Bill 196
BILL TITLE: Economic Development – Research and Development Tax Credit - Alterations
POSITION: Support

The Maryland Department of Commerce (Commerce) supports Senate Bill 196 – Economic Development – Research and Development Tax Credit - Alterations.

Bill Summary:

Senate Bill 196 alters the Maryland Research and Development Tax Credit by:

- Eliminating the tax credit for basic research and development;
- Reallocating the \$5.5 million available for basic research and development tax credits to growth research and development tax credits, which will increase the amount of growth research and development tax credits from \$6.5 million to \$12 million;
- Creating a small business research and development tax credit by reserving \$3.5 million worth of growth tax credits for small businesses;
- Allowing for the transfer of unused tax credits between the \$3.5 million designated for small business, and the \$8.5 million designated for non-small businesses;
- Limiting the amount of a research and development tax credit to \$250,000 per company per year;
- Defining the term “net book value assets,” which is used to define small businesses for the research and development tax credit; and
- Extending the tax credit to 2025.

Background:

The Maryland Research and Development Tax Credit was enacted in 2000 and was patterned after the federal research and development tax credit. Companies may receive a State tax credit worth 3% of the eligible “base”, or the average research and development expenditures incurred in Maryland within the last four years, and a State tax credit worth 10% of “growth” in research and development expenditures during the taxable year in excess of the prior four-year average. Commerce is authorized to certify a total of \$12 million in research and development tax credits per year with \$5.5 million reserved for base research and development tax credits, and \$6.5 million reserved for growth research and development tax credits.

Commerce analyzed five years of certified research and development tax credits and found: (1) research and development tax credits are devalued due to oversubscription, and as a result of prorating the tax credit companies receive a certified credit that is 15% to 20% of the amount for which they were eligible; (2) a few companies with large research and development expenditures skew the awarding of certified credits, and receive a disproportionate amount of the tax credits;

(3) small businesses are increasingly applying for the tax credit, and are certified for smaller tax credits having to compete with larger businesses; and (4) given its limited resources relative to demand, the research and development tax credit will be more effective by focusing solely on incentivizing new research and development.

Rationale:

Research and development spurs innovation that benefits the economy, standard of living, and society as a whole. Gene sequencing techniques developed during the federally sponsored human genome research project, which was completed in 2000, are being used to study the COVID-19 virus. Currently, thirty-three states, including Virginia, Pennsylvania, Delaware, and Massachusetts, incentivize research and development with a tax credit.

Maryland's Research and Development Tax Credit was patterned after the federal research and development tax credit; however, the State does not have the same level of resources as the federal government. A more targeted, strategic tax credit focusing on new research and development will provide a more effective incentive given the State's limited resources.

Senate Bill 196 seeks to improve Maryland's Research and Development Tax Credit by addressing the findings of Commerce's analysis of the tax credit. Focusing on new research by eliminating the basic credit will provide a more meaningful incentive that encourages new research and development. Eliminating the basic credit will also put Maryland more on par with other states as most states do not appear to offer a basic credit, and of those that do, a basic credit is restricted to specific industries. Limiting the amount of the tax credit awarded per company to \$250,000 will provide a significant incentive that encourages more companies to conduct new research and development by addressing a few companies receiving a disproportionate amount of the tax credit. Capping the tax credit and providing more resources for the growth credit will create a more effective incentive that focuses on new research and development.

Currently, small businesses compete for a tax credit with large businesses that are able to invest more in research and development. Establishing a \$3.5 million research and development tax credit specifically for small businesses will provide a larger tax credit for small businesses that will help them grow.

The current statute defines a small business for the Research and Development Tax Credit as a business having less than \$5.0 million in net book value assets; however, the statute does not define net book value assets. Defining the term net book value assets in statute will improve the Department's ability to administer the tax credit.

Commerce respectfully requests a favorable report on Senate Bill 196.