HB 1089

Department of Legislative Services

Maryland General Assembly
2015 Session

FISCAL AND POLICY NOTE

House Bill 1089 (Delegate Beitzel, *et al.*)
Economic Matters and Ways and Means

Economic Development - Rural Economic Development Program and One Maryland Tax Credit

This bill establishes the Rural Economic Development Program, under which a qualified business in 18 specified counties is eligible for 10 years of property, income, and sales tax benefits. The bill also establishes the Rural Economic Development Program Infrastructure Fund to issue grants to 8 eligible counties for specific capital purposes. The Governor must appropriate $5.0 million annually in the operating or capital budget from fiscal 2017 through 2021 to the fund. The definition of "qualified distressed county" for purposes of the One Maryland Tax Credit Program is altered to permanently remove eligibility for counties who become ineligible for any period of time.

Fiscal Summary

State Effect: General and special fund revenues decrease significantly beginning in FY 2016 from tax incentives, the majority of which is anticipated to be from the general fund, and a portion of which may be partially offset by the change to the One Maryland program. General obligation bond (GO) or general fund pay-as-you-go (PAYGO) expenditures increase by at least $5.0 million annually from FY 2017 through 2021. Special fund revenues and expenditures for the Department of Business and Economic Development (DBED) increase correspondingly. General fund expenditures for DBED and the Comptroller for administrative expenses increase by $226,600 beginning in FY 2016. **This bill establishes a mandated appropriation beginning in FY 2017**.

($ in millions)	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
GF Revenue	(-)	(-)	(-)	(-)	(-)
SF Revenue	(-)	$5.0	$5.0	$5.0	$5.0
GF Expenditure	$0.2	0.3	0.3	0.3	0.3
SF Expenditure	0	5.0	5.0	5.0	5.0
PAYGO GF exp	0	5.0	5.0	5.0	5.0
Net Effect	($0.2)	($5.3)	($5.3)	($5.3)	($5.3)

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

Local Effect: Local income tax revenues decrease by about 3% of the total net State subtraction modification claimed beginning in FY 2016. Local real and personal property tax revenues decrease beginning in FY 2017 from property tax exemptions taken by qualified businesses. Further, local highway user revenues potentially decrease beginning in FY 2016 from reduced corporate income tax (CIT) revenue, which may be partially offset by increased CIT revenue due to the change to the One Maryland program. Local revenues and expenditures increase to the extent a county receives an infrastructure grant under the program. **This bill imposes a mandate on a unit of local government**.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The Rural Economic Development Program is established to (1) encourage businesses to locate and expand in specified rural counties of the State and (2) provide specified rural counties of the State with a source of funding for the expansion of infrastructure necessary to encourage businesses to locate and expand in those counties.

Location and Expansion of Businesses in Rural Counties

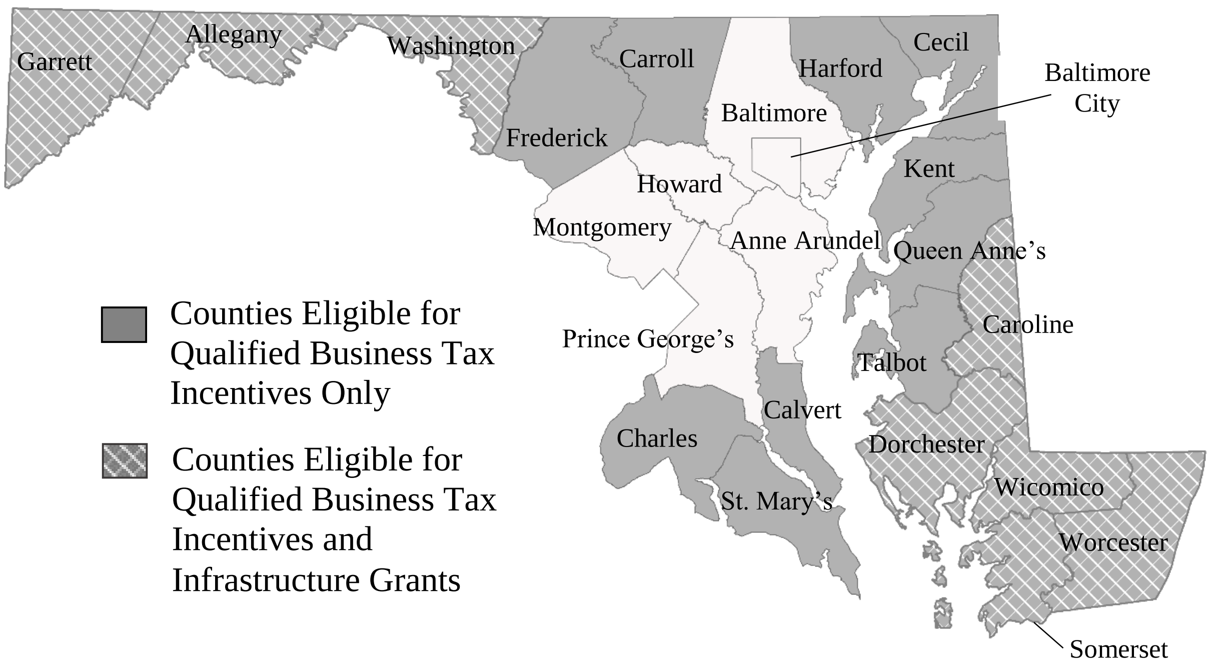
DBED may certify a business as a qualified business in one or more of 18 specified counties, as shown in **Exhibit 1**, if (1) the business applies to DBED; (2) meets any additional requirements established by DBED; and (3) provides evidence of an intention to expand a business in an eligible county and to hire at least 20 additional employees in an eligible county. A business may not be designated as a qualified business if the activities of the business are primarily retail.

For each of the 10 taxable years after a business is designated as a qualified business under the bill, the qualified business is entitled to the following tax incentives:

- the property tax exemption under § 7-245 of the Tax – Property Article;
- the income tax subtraction modification under §§ 23 10-207(cc) (corporate income) or 10-307(g)(5) (personal income) of the Tax – General Article; and
- the sales and use tax exemption under § 11-232 of the Tax – General Article.

DBED may not designate a business as a qualified business under the bill after September 30, 2025. DBED must adopt regulations to implement these provisions of the bill.

Exhibit 1
Counties Eligible for Business Tax Incentives and Infrastructure Grants



Source: Department of Legislative Services

Infrastructure Funding

The Rural Economic Development Program Infrastructure Fund is established as a special, nonlapsing fund to provide specified rural counties of the State with a source of funding for the expansion of infrastructure necessary to encourage businesses to locate and expand in those counties. The fund consists of (1) money appropriated in the State budget to the fund; (2) investment earnings of the fund; and (3) any other money from any other source accepted for the benefit of the fund.

For fiscal 2017 through 2021, the Governor must include in the annual operating or capital budget an appropriation to the fund of at least $5.0 million. Expenditures from the fund may be made only in accordance with the State budget.

The fund may be used only for grants to eligible counties, as shown in Exhibit 1, for the purchase of land or the construction of public buildings, water and sewer projects, or roads. Money expended from the fund for grants to counties is supplemental to and is not intended to take the place of funding that otherwise would be appropriated for infrastructure projects within a county. If a county sells an asset that benefits from a grant, the county must reimburse the fund in the amount of the grant received.

Tax Incentives for Qualified Businesses

A qualified business is eligible for a subtraction modification for the personal income tax or CIT. In addition, property is not subject to property tax if the property is owned by a qualified business. Both the subtraction modification and the property tax exemption can be taken for up to the 10 taxable years following the designation of a business as a qualified business. Finally, the sales and use tax does not apply to a sale of capital equipment used as part of the activities of a qualified business in a county in which the business expanded as part of its application to be a qualified business.

One Maryland Program Eligibility Change

The definition of "qualified distressed county" for purposes of the One Maryland Tax Credit Program is altered to permanently remove eligibility for jurisdictions that become ineligible for any period of time. However, the definition change may not be construed to prohibit Baltimore City or Allegany, Caroline, Dorchester, Somerset, Washington, or Worcester counties from participating in the program until the jurisdiction fails to meet the definition of a qualified distressed county. The bill further specifies the intent of the General Assembly that the cost savings from this change offset the additional cost of the program enacted by the bill.

Current Law:

Qualified Distressed County

A project must be in a qualified distressed county and in a priority funding area to qualify for the One Maryland program. To qualify as a distressed county, a county must have:

- an average unemployment rate that exceeded the State's average during the preceding 24-month period by either 2 percentage points or 150%; or
- a per capita personal income that may not exceed 67% of the State's average during the preceding 24-month period.

A distressed county also includes any county that no longer meets the unemployment and personal income criteria but has met at least one of the criteria at some point in the preceding 24-month period. Counties can enter and exit the program based on these criteria.

Background:

Economic Development Tax Incentives

Numerous federal, State, and local programs with a similar focus and objective to the program established under the bill are currently in place. Incentives that aim to increase employment or economic development within distressed areas or similar areas include the One Maryland economic development tax credit, Enterprise Zone tax credit, Job Creation tax credit, Base Realignment and Closure Revitalization and Incentive Zone Program, Brownfields tax credit, Community Investment tax credit, and Sustainable Communities tax credit.

One Maryland Economic Development Tax Credit

In response to concerns about the impacts of tax credits, Chapters 568 and 569 of 2012 established the Tax Credit Evaluation Act, a legislative process for evaluating certain tax credits. The evaluation process is conducted by a legislative evaluation committee. The committee was required to review and evaluate the One Maryland economic development tax credit by July 1, 2014. The final report on the credit was completed in August 2014 and can be found here.

Chapter 303 of 1999 established the One Maryland economic development tax credit, designed to assist in paying for both project expansion and start-up costs for certain businesses that add at least 25 qualified employees in distressed counties. The One Maryland tax credit is a high-value, low utilization credit compared to other business tax credits. Credits can be claimed against certain income and taxes in each year. As of August 2014, DBED had certified a total of $197.4 million in One Maryland tax credits; however, only about one-third of this amount had been claimed at that time, thus creating a large pipeline of unclaimed credits. Companies generally have 15 years to claim the entire amount of the credit; therefore, *existing* projects will continue to decrease State revenues by up to $136 million through tax year 2025 (fiscal 2026). This revenue loss is before any revenue losses that will result from new projects going forward. Since the program is not subject to an annual aggregate limitation, the amount of credits that will be certified each year cannot be accurately predicted.

As of the end of fiscal 2014, Baltimore City and Allegany, Caroline, Dorchester, Somerset, Washington, and Worcester counties were considered qualified distressed counties.

State Aid for Transportation Infrastructure

In fiscal 2015, local governments received $169.7 million in State aid through highway user revenues and $16.0 million through municipal transportation grants for the construction and maintenance of local roads. Local governments also received $7.2 million for special transit grants. Counties eligible for the infrastructure grants under the bill are highlighted in **Exhibit 2**. The combined total aid to those counties in fiscal 2015 is $12.0 million, or 6.2%, of the total aid provided to all local governments.

Exhibit 2
Transportation Aid Programs
Fiscal 2015

County	Highway User Revenues	Municipal Grants	Elderly/ Disabled	Paratransit	Total Aid
Allegany	$820,822	$809,832	$141,544	$68,400	$1,840,598
Anne Arundel	3,148,028	698,158	245,996	416,000	4,508,182
Baltimore City	136,102,428	0	379,335	0	136,481,763
Baltimore	4,004,521	0	395,836	0	4,400,357
Calvert	701,291	198,831	127,003	76,099	1,103,224
Caroline	511,026	286,110	120,217	40,000	957,353
Carroll	1,496,445	925,146	151,029	0	2,572,620
Cecil	833,388	463,297	134,073	0	1,430,758
Charles	1,034,239	264,130	137,609	175,848	1,611,826
Dorchester	574,998	329,211	122,724	50,000	1,076,933
Frederick	2,087,612	1,764,578	159,159	460,000	4,471,349
Garrett	629,723	262,429	119,664	0	1,011,816
Harford	1,690,629	775,904	170,371	40,592	2,677,496
Howard	1,531,557	0	162,520	430,000	2,124,077
Kent	295,694	170,016	120,217	0	585,927
Montgomery	4,712,706	2,546,645	379,108	0	7,638,459
Prince George’s	4,257,842	3,276,302	332,819	446,663	8,313,626
Queen Anne’s	560,814	109,824	122,064	0	792,702
St. Mary’s	785,018	70,845	131,054	135,000	1,121,917
Somerset	327,969	122,127	117,447	96,667	664,210
Talbot	511,139	437,810	120,217	0	1,069,166
Washington	1,314,937	1,051,976	146,917	188,100	2,701,930
Wicomico	1,021,159	892,293	134,507	96,667	2,144,626
Worcester	732,161	544,537	134,508	206,666	1,617,872
Total	**$169,686,146**	**$16,000,001**	**$4,305,938**	**$2,926,702**	**$192,918,787**

Notes: Highway User Revenues column includes Municipal Aid; shaded counties are eligible for infrastructure grants under the bill.

Source: Department of Legislative Services

State Fiscal Effect: General and special fund revenues decrease significantly beginning in fiscal 2016 from tax incentives taken by qualified businesses, the majority of which is anticipated to be from the general fund, and a portion of which may be partially offset by the change to the One Maryland program. GO bond or general fund PAYGO expenditures increase by at least $5.0 million annually from fiscal 2017 through 2021. Special fund revenues and expenditures for DBED increase correspondingly to issue grants to eligible counties. General fund expenditures for DBED and the Comptroller for administrative expenses increase by $226,555 beginning in fiscal 2016.

Location and Expansion of Businesses in Rural Counties and Infrastructure Funding

Demand for the program cannot be reliably estimated at this time. Even so, general fund revenues, Transportation Trust Fund (TTF) revenues, and Higher Education Investment Fund (HEIF) revenues decrease significantly beginning in fiscal 2016 from subtraction modifications and sales tax exemptions taken under the bill by qualified businesses. Special fund revenues for the Annuity Bond Fund decrease beginning in fiscal 2017 from real property tax exemptions taken under the bill by qualified businesses. The annual cost and the allocation of the revenue decreases cannot be reliably estimated at this time; however, given the revenue structure of the possible taxes to which the credit may apply, the majority of the revenue decrease is anticipated to be from the general fund.

GO bond or general fund PAYGO expenditures increase by at least $5.0 million annually from fiscal 2017 through 2021 from the mandated appropriation to the Rural Economic Development Program Infrastructure Fund. Special fund revenues and expenditures for DBED increase correspondingly as DBED issues grants under the program.

The bill specifies that the Rural Economic Development Program Infrastructure Fund may be used only for grants to eligible counties. Therefore, general fund expenditures for DBED administrative expenses increase by $83,556 in fiscal 2016, which accounts for the bill's October 1, 2015 effective date. This estimate reflects the cost of hiring one finance/tax specialist to administer the program established under the bill and to issue grants to eligible counties. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	1
Salary and Fringe Benefits	$78,832
Other Operating Expenses	4,724
Total FY 2016 DBED Expenditures	**$83,556**

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

General fund expenditures for the Comptroller increase by $142,999 in fiscal 2016, which accounts for the bill's October 1, 2015 effective date. This estimate reflects the cost of hiring two tax specialists to audit and review tax incentives taken by qualified businesses under the program established by the bill. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2
Salaries and Fringe Benefits	$133,551
Other Operating Expenses	9,448
Total FY 2016 Comptroller Expenditures	**$142,999**

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

One Maryland Program Eligibility Change

Based on the historical tendency of counties to lose and regain their status as qualified distressed counties under the One Maryland program and that, therefore, one or more counties will eventually be permanently removed from the One Maryland program under the bill, general fund revenues increase, TTF revenues increase, and HEIF revenues increase, potentially as early as fiscal 2016, due to the change to the One Maryland program. The amount, however, cannot be reliably estimated. Two counties are currently in the two-year grace period of the program under current law – Washington and Caroline.

Local Fiscal Effect: In the 18 eligible counties, local income tax revenues decrease by about 3% of the total net State subtraction modification claimed beginning in fiscal 2016. Local real and personal property tax revenues decrease beginning in fiscal 2017 from real and personal property tax exemptions taken by qualified businesses. Local highway user revenues potentially decrease beginning in fiscal 2016 from reduced CIT revenue, which may be partially offset by increased CIT revenue due to the change to the One Maryland program. Local revenues and expenditures increase to the extent a county receives an infrastructure grant under the program.

Small Business Effect: The bill provides qualified businesses with tax benefits for 10 taxable years. The certification process requires a business to provide evidence of an intention to expand in an eligible county and to hire at least 20 additional employees in an eligible county. Conceivably, a small business could expand into an eligible county, hire 20 additional employees, and still remain a small business. These small businesses would benefit from the tax incentives provided under the bill. It is unlikely, however, that all qualified businesses will be small businesses.

Additional Comments: The bill specifies that investment earnings of the fund must be credited to the new special fund. However, the bill does not amend § 6-226 of the State Finance and Procurement Article to exempt the fund from existing law that requires all investment earnings and interest from special funds to accrue to the general fund.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, SB 196 (Senator Edwards, *et al.* - Budget and Taxation) is not identical.

Information Source(s): Comptroller's Office, Department of Business and Economic Development, State Department of Assessments and Taxation, Department of Budget and Management, Department of Legislative Services

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min/rhh

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