HB 742

Department of Legislative Services

Maryland General Assembly
2014 Session

FISCAL AND POLICY NOTE

House Bill 742 (Delegate Walker, *et al.*)
Ways and Means

Regional Institution Strategic Enterprise Zone Program

This bill establishes the Regional Institution Strategic Enterprise (RISE) Zone Program, to be administered by the Department of Business and Economic Development (DBED). The purpose of the RISE Zone program is to access institutional assets that have a strong and demonstrated history of commitment to economic development and revitalization in the communities in which they are located. A qualified institution may apply to DBED for designation of an area as a RISE zone. A business entity that locates in a RISE zone is entitled to a property tax credit, an income tax credit, a special income tax depreciation allowance, and consideration for assistance from the State's economic development and financial assistance programs.

A qualified institution may apply to designate an area as a RISE zone beginning July 1, 2015.

Fiscal Summary

State Effect: State revenues may decrease significantly due to income tax credits and additional depreciation claimed against the income tax. General fund expenditures increase by $347,200 in FY 2016 due to implementation costs. General fund expenditures may decrease beginning in FY 2017 due to a reduction in State Enterprise Zone property tax credit reimbursements.

Local Effect: Property tax revenues in counties and municipalities in which a RISE zone is designated may decrease significantly as a result of the bill. Local income tax revenues and local highway user revenues will decrease due to income tax credits and additional depreciation claimed against the income tax. Local expenditures may increase minimally to administer the program.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: A qualified institution includes (1) an elementary or secondary public school; (2) an institution of higher education (public and private four-year institutions and community colleges); or (3) a nonprofit organization that is affiliated with either public school construction/renovation or with a federal agency.

The Secretary of Business and Economic Development may designate an institution as a qualified institution if the institution:

- has evidence of an intention to (1) make a significant financial investment or commitment; (2) use the resources and expertise of the institution to spur economic development and community revitalization; and (3) create a significant number of new jobs in an area that is proposed to become a RISE zone;
- has demonstrated a history of community involvement and economic development within the communities that the institution serves; and
- meets the minimum financial qualifications established by the Secretary of Business and Economic Development.

The Secretary of Business and Economic Development must adopt regulations on evaluating applications and may establish other requirements by regulation for RISE zone designations. A qualified institution may apply to the Secretary of Business and Economic Development to designate an area as a RISE zone beginning July 1, 2015, and the application must include specified information. At least 60 days before approval or rejection of an application, the Secretary of Business and Economic Development must notify the Legislative Policy Committee and the county or municipal corporation in which the proposed RISE zone is located so that they may provide advice to the Secretary. The Secretary must approve or reject an application for designation of a RISE zone within 90 days of submission of an application.

The Secretary of Business and Economic Development must assign a business development concierge, who is an employee of DBED, to a RISE zone to assist entities locating in the RISE zone with State or local permit and license applications, accessing existing programs at DBED, the Department of Housing and Community Development, or the Maryland Department of Transportation, and any other authorized activities relating to the development of the RISE zone.

A business may qualify for (1) a property tax credit; (2) an income tax credit; (3) a special income tax depreciation allowance; and (4) consideration for assistance from DBED financial assistance programs. These programs include the Maryland Economic Adjustment Fund (MEAF), Maryland Economic Development Assistance Authority and Fund (MEDAAF), Maryland Industrial Development Financing Authority (MIDFA), and the Maryland Small Business Development Financing Authority (MSBDFA).

Tax credits may be awarded to a business entity that (1) moves into or locates in a RISE zone on or after the date that the zone is designated or (2) is located within the zone prior to designation if the business entity makes a significant capital investment or expansion of its labor force after a RISE zone is designated. DBED must adopt regulations establishing criteria to determine significant capital investments or expansion of its labor force.

Property Tax Credit

A local government must grant a 10-year property tax credit against local real property taxes imposed on the eligible assessment of qualified property owned by a business entity. A business entity is a person who operates or conducts a trade or business, and it includes a person who operates, develops, constructs, or rehabilitates real property if the real property is intended for use primarily as single or multifamily residential property and is partially devoted to a nonresidential use. Qualified property is real property that is not used for residential purposes, used in a trade or business by a business entity, and located in a RISE zone. State property taxes imposed on real property are not affected.

The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property improvements, which is calculated by the State Department of Assessments and Taxation (SDAT). Enhanced credits are granted if the property is located within a State enterprise zone or focus area within an enterprise zone.

As shown in **Exhibit 1**, the credit is applied to the tax imposed on 80% of the eligible assessment during the first five years, decreasing by 10% annually to 30% in the tenth and final year. For qualified property within an enterprise zone, a business can receive the 80% credit for the full 10-year period, and for qualified property within a focus area of an enterprise zone, a business can receive a 100% credit for the full 10-year period.

Exhibit 1
RISE Zone Property Tax Credit
Percentage of Eligible Property Assessment

Taxable Year	Percentage
1-5	80%
6	70%
7	60%
8	50%
9	40%
10	30%

Source: Department of Legislative Services

If the designation of a RISE zone expires, the property tax credit continues to be available to a qualified property.

The Secretary of Business and Economic Development must certify to SDAT that the properties are qualified properties for each taxable year for which the property tax credit is to be granted and the date that the real properties became qualified properties. SDAT must submit to DBED specified information regarding the qualified properties. Local governments are required to grant the property tax credits and calculate the value of the credit each year.

Income Tax Incentives

Qualified property within a RISE zone may be depreciated 100% in the year in which the property is placed in service. Additionally, a qualified business entity within a RISE zone may claim Enterprise Zone income tax credits. **Exhibit 2** shows the value of these income tax credits.

Exhibit 2
Enterprise Zone and Focus Area
Income Tax Credit

Enterprise Zone	
Regular employee	$1,000 per employee (one-time)
Economically disadvantaged employee	$6,000 per employee (over three years)
Focus Area	
Regular employee	$1,500 per employee (one-time)
Economically disadvantaged employee	$9,000 per employee (over three years)

Source: Department of Business and Economic Development

Current Law:

Enterprise Zone Property Tax Credit

Businesses located or locating in an enterprise zone may receive a 10-year property tax credit against local real property taxes. The amount of the property tax credit is based on a specified percentage of assessment increases resulting from the value of real property improvements. The credit is applied to the tax imposed on 80% of the eligible assessment during the first five years, and decreases by 10% annually to 30% in the final year. Within a focus area, a business can receive the 80% credit for the full 10-year period. In addition, businesses in a focus area may be eligible for a 10-year, 80% tax credit against local personal property taxes on new investment. During the course of the property tax credit period, SDAT is responsible for reimbursing local governments (through the department's annual general fund budget) for 50% of the property tax revenue lost as a result of the credit.

In order to obtain the property tax credit, a business located within a designated enterprise zone must contact the local enterprise zone administrator to determine whether a particular property meets specific requirements within a given enterprise zone. While State law indicates that businesses may qualify for the credit by making capital improvements or hiring new employees, local enterprise zones may establish additional requirements (*e.g.*, qualifying businesses must hire a certain number of new employees or that the jobs created must be in certain industries). Following a determination by the local administrator that a property qualifies for the credit, the administrator certifies this finding in writing to SDAT. SDAT will then calculate the amount of the assessment that is eligible to receive the credit. In addition to computing the amount of the eligible property assessment, SDAT is required to keep track of each property that has been certified by the local enterprise zone administrator and notify each local jurisdiction of its property tax credit obligation. It should be noted that the credit is granted to the owner of the qualifying property. In cases where a lessee makes the capital improvements, the lessee is responsible for executing an agreement with the owner of the property regarding the receipt of the property tax credit.

Enterprise Zone Income Tax Credit

There are two types of income tax credits for firms located within an enterprise zone: a general income tax credit and a larger income tax credit for hiring economically disadvantaged employees. As shown in Exhibit 2, the general income tax credit is a one-time $1,000 credit per new employee filling a newly created position, or $1,500 for each qualified new employee in a focus area. For economically disadvantaged employees, the credit increases to a total of $6,000 per new employee, or $9,000 per new employee in a focus area. The tax credit for economically disadvantaged employees is claimed over a three-year period.

Similar to the property tax credit, businesses located in an enterprise zone must be certified by the local enterprise zone administrator in order to be eligible to receive the income tax credit (including the focus area credit). To qualify for the credit, businesses must hire at least one employee who (1) is hired after the business was located in the enterprise zone or after the enterprise zone was designated; (2) is employed by the business for at least 35 hours per week for 6 months (or 12 months in a focus area) before or during the taxable year in which the credit is taken; (3) spends at least 50% of the workday either in the enterprise zone or on an activity related to the enterprise zone; (4) is hired to fill a new position (*i.e.*, the firm's number of new full-time positions must increase by the number of credits taken); and (5) earns at least 150% of the federal minimum wage. Businesses claiming the credit for hiring an economically disadvantaged employee must obtain certification from the Department of Labor, Licensing, and Regulation (DLLR). Once certified, a business may claim the income tax credit.

Depreciation

Depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property. Specific rules under § 168 of the Internal Revenue Code govern the amount of depreciation that can be deducted in each year based on the allowable method, class life of the property, depreciable basis of the property, and whether any amount is expensed.

The State generally conforms to federal depreciation and expensing rules. However, the State is currently decoupled from any additional depreciation amounts under § 168(k) and expensing under § 179 of the Internal Revenue Code. Taxpayers are required to make an adjustment for Maryland income tax purposes to reflect the changes made to the depreciation allowance under § 168(k) and expensing under § 179.

DBED Business Financing Assistance

The 1997 Priority Funding Areas Act directs State funding for growth-related infrastructure to priority funding areas (PFAs), providing a geographic focus for State investment in growth. PFAs are existing communities and places where local governments want State funding for future growth. Growth-related projects include most State programs that encourage growth and development such as highways, sewer and water construction, economic development assistance, and State leases or construction of new office facilities.

Background:

Enterprise Zone Tax Credit Program

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. As of September 2013, there are 30 enterprise zones in 12 counties and Baltimore City. The Secretary of Business and Economic Development may only designate an area as an enterprise zone if it is in a priority funding area and satisfies at least one criterion related to economic distress.

The State reimburses local governments for one-half of the cost of the Enterprise Zone property tax credit. From fiscal 2001 to 2014, State reimbursements to local governments totaled $131.2 million. In fiscal 2014, about 850 properties earned a total of $27.8 million in property tax credits, of which the State reimbursed $13.9 million. Since tax year 2000, an annual average of $900,000 in Enterprise Zone income tax credits have been claimed. About 100 tax returns claimed $634,900 in income tax credits in tax year 2010.

Pursuant to the Tax Credit Evaluation Act of 2012, the Department of Legislative Services (DLS) evaluated the Enterprise Zone tax credit and made several recommendations in a draft report issued in November 2013. These findings included:

- **Enterprise Zone tax credits are not effective in creating employment opportunities for enterprise zone residents:** While Enterprise Zone tax credits may incentivize some businesses to create additional jobs within enterprise zones, the tax credit is not particularly effective in providing employment to zone residents that are chronically unemployed and/or live in poverty. Additionally, annual claims for the Enterprise Zone income tax credit have been modest, and administrative burdens associated with the enhanced credit for members of a disadvantaged family may be contributing to low utilization rates.

- **In a significant number of zones, few businesses are claiming the credit:** Some enterprise zones have failed to attract many businesses, and a number of the businesses claiming the tax credit are not making significant investments in those zones.

- **DBED, SDAT, and local governments do not have a framework or metrics in place for measuring the effectiveness of the credit:** There is a lack of (1) accurate data on the change in employment and number of businesses within enterprise zones, which has hindered the ability to assess the impact of the credit and (2) standardization in the data that each county assessment office provides about properties claiming the Enterprise Zone property tax credit.

- **Enterprise zone expansions have become more prevalent:** Utilization of the property tax credit has greatly increased in recent years. There are few limitations on zone expansions and no specific criteria related to zone expansion requirements. The program is not subject to an overall limitation on what can be spent each year, and program costs may increase significantly as credits are granted to properties in new development projects.

DLS made recommendations on improving the effectiveness of the Enterprise Zone tax credit, which included reducing the administrative burden of claiming the income tax credit, adopting formal metrics and a framework for analyzing the cost-effectiveness of the enterprise zone incentives, evaluating the criteria for enterprise zone expansions, and providing uniform Enterprise Zone tax credit data collection procedures in each county. The DLS evaluation of the Enterprise Zone tax credit can be found at: http://mgaleg.maryland.gov/Pubs/BudgetFiscal/2013-Evaluation-Enterprise-Zone-Tax-Credit-DRAFT.pdf.

Business Tax Credits and Financial Assistance

Since the establishment of the Enterprise Zone program the State has created almost 30 additional business tax credits. Of the current business tax credits, about one-quarter are employment tax credits and one-half are related to economic development. Employment tax credits include the enterprise zone, job creation, businesses that create new jobs, One Maryland, and health enterprise zone credits. State incentives that target distressed or similar areas include the enterprise zone, job creation, community investment, and sustainable communities tax credits. State business assistance programs which provide loans and grants or develop property for business use include MEDAAF, MIDFA, MSBDFA, and Maryland Economic Development Corporation. In addition, local governments have established and expanded the use of financial assistance, job creation, and economic development tax credits; tax increment financing, payment-in-lieu-of-taxes; and special taxing districts in order to subsidize infrastructure and development within targeted areas. These State and local programs are in addition to federal tax incentives which aim to encourage employment and investment.

In its draft evaluation of the One Maryland tax credit, issued in October 2013, DLS noted that there was significant overlap between existing State tax credit and business assistance programs. DLS estimated that only 3 or 9% of the 33 One Maryland projects in Baltimore City did not receive additional assistance from the specified programs. A little more than one-half of all projects received at least one type of additional assistance while the remaining 39% received multiple types of additional assistance.

Depreciation

Depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property over several years. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property. The U.S. Congress has enacted legislation several times providing for a temporary additional depreciation amount for the first year in which property is placed in service. Bonus depreciation is designed to provide an incentive for businesses to make capital investments by allowing immediate deductions that result in a decrease in tax liabilities and reduce the after tax cost of acquiring capital. Only certain types of property has qualified for this bonus depreciation and is generally limited to property with recovery periods of 20 years or less.

This federal bonus depreciation has allowed taxpayers to depreciate between 30% and 100% of the adjusted basis of certain qualified property during the year that the property is placed in service. The bonus depreciation for qualifying property placed in service during 2013 is equal to 50%. Certain longer-lived and transportation equipment can qualify for this bonus depreciation if placed in service through 2014, but otherwise bonus depreciation is not allowed for properties acquired after December 31, 2013.

State Revenues: State revenues will decrease as a result of income tax credits and additional depreciation amounts claimed against the personal and corporate income tax. The amount of the State revenue loss depends on the number and size of the zones, the location of the zones, and the amount of qualifying business activity that occurs in each zone. There is no limitation on the number of zones that can be designated or the size of the zone. Each of the estimates below is based on the existing Enterprise Zone tax credit program, and assumes that RISE zones will be significantly smaller in size. In addition, the characteristics of RISE zones may be significantly different than that of enterprise zones. Each of the potential impacts is discussed below.

Depreciation

Qualified property within a RISE zone may be depreciated 100% in the year in which the property is placed in service. It is anticipated that this provision will have the largest impact on State revenues. DLS estimates that 50% bonus depreciation for all property in the State would decrease revenues by $291.5 million in the first year in which it is in effect, with revenues increasing in each year thereafter. These estimates reflect only property which qualifies under § 168(k). **Exhibit 3** shows, *for illustrative purposes only*, the potential impact on State and local revenues if 1% of the total qualified property in the State is placed in service within a RISE zone and is eligible for 100% depreciation under the bill. The amount of revenue loss will occur in the first year in which eligible property is placed in service within a zone.

Exhibit 3
Potential State and Local Income Tax Loss
Additional Depreciation
($ in Millions)

	Year 1	Year 2	Year 3	Year 4	Year 5
Total State Revenues	**($4.5)**	**($3.2)**	**($2.2)**	**($1.6)**	**($1.1)**
General Fund	(3.7)	(2.6)	(1.9)	(1.3)	(0.9)
HEIF	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)
TTF	(0.6)	(0.4)	(0.3)	(0.2)	(0.1)
State	(0.5)	(0.4)	(0.2)	(0.2)	(0.1)
Local	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)
Local Income Tax Revenues	**($0.6)**	**($0.4)**	**($0.3)**	**($0.2)**	**($0.1)**

Revenue impacts may be significantly higher than estimated. For example, if 5% of eligible activity occurs within a RISE zone, general fund revenues will decrease by $22.5 million in the first year in which qualified property is placed in service. In addition, to the extent property with longer recovery periods qualify, revenue losses will be greater. Nonresidential real estate is generally depreciable over 39 years. Under the bill, if a building with a value of $10.0 million is built within a RISE zone, the full amount can be dedicated in the first year rather than over 39 years.

Income Tax Credits

Qualifying businesses within RISE zones can claim Enterprise Zone tax credits. As a result, general fund and special fund revenues will decrease beginning in the year in which eligible activity occurs. Since tax year 2000, an average of $900,000 in Enterprise Zone income tax credits have been claimed, and income tax credits made up only 4% of the total Enterprise Zone tax credit costs in tax year 2010. As a result, it is anticipated that State revenues will likely decrease by a maximum of $100,000 annually.

State Expenditures: DBED may designate zones beginning in fiscal 2016. As a result, general fund expenditures increase by $347,200 in fiscal 2016 due to implementation costs at DBED, SDAT, and the Comptroller’s Office, as described below. In addition, State expenditures may decrease due to a savings in State enterprise zone reimbursements.

DBED advises that it would incur additional costs beginning in fiscal 2016 as a result of hiring one business development concierge. As a result, general fund expenditures increase by $102,900 in fiscal 2016.

SDAT will incur additional costs beginning in fiscal 2016 as a result of hiring one administrator to process property tax credits. As a result, general fund expenditures increase by $79,700 in fiscal 2016. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

The Comptroller's Office reports that it will incur a one-time expenditure increase of $164,600 in fiscal 2016 to add the business tax credit and addition and subtraction modifications. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing.

Positions	2
Salary and Fringe Benefits	$172,680
Operating Expenses	9,912
SDAT/DBED Expenditures	**$182,592**
Comptroller Expenditures	**$164,600**
Total FY 2016 Expenditures	**$347,192**

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

Property Tax Reimbursements

The bill does not prevent a business from claiming both the property tax credit proposed by the bill and the Enterprise Zone tax credit but specifies that a business located within a RISE zone that is also within an enterprise zone or focus area qualifies for enhanced property tax credits. To the extent the zones overlap and businesses claim RISE property tax credits, State reimbursement expenditures under the Enterprise Zone program may be mitigated. The amount depends on the overlap between the two programs, if any, and the amount of qualifying investments made. This impact and the potential State enterprise zone reimbursement savings are discussed in more detail below.

Local Revenues: Property tax and local income tax revenues will decrease in counties and municipalities in which a RISE zone is designated. In addition, local highway user revenues distributed to all counties and Baltimore City will decrease as a result of credits and additional depreciation amounts claimed against the corporate income tax. Each of the impacts is discussed below.

Property Tax

Property tax revenues in counties and municipalities in which a zone is designated will decrease as a result of the bill. The amount of the revenue loss depends on the number and size of the zones, the location of the zones, the amount of qualifying activity that occurs in each year, and whether an area designated as a RISE zone is currently designated as an enterprise zone.

In fiscal 2014, a total of $2.4 billion in assessments was eligible for the Enterprise Zone property tax credit, of which $1.1 billion was located in Baltimore City. These assessments are for credit activity within the last 10 years. The Baltimore City enterprise zone totals 13,450 acres, comprising a significant portion of Baltimore City's commercial areas. Within the last 10 years, an annual average of $109.8 million in assessable property has become eligible for the credit in Baltimore City, which is a rough approximation of the eligible property investment in each year. On average, the average property in Baltimore City had an eligible assessment (and investment) of $3.8 million, with over 20 properties having an eligible assessment of over $10.0 million. For each acre in an enterprise zone in Baltimore City, about $8,200 in new investments are made each year. Utilization of the credit is significantly higher in Baltimore City than in other counties, as is the cost since the Baltimore City property tax rate is significantly higher than other counties.

For illustrative purposes only, **Exhibit 4** shows the potential fiscal impact if a constant $5 million in investments are made each year in Baltimore City, as well as the average impact across all counties and Baltimore City. Since the credit is taken over 10 years, revenue losses will increase as the number of properties eligible for the credit increase and would reflect the growth in assessments and eligible investments after the tenth year.

Exhibit 4
Potential Local Property Tax Losses and State Savings
$5 Million in Annual Investments

	Local Property Tax Loss		
Year	**Baltimore City**	**Average County**	**State Savings**
1	($58,400)	($35,000)	$36,600
5	(313,400)	(187,600)	196,000
10	(702,200)	(324,900)	350,500

Note: Assumes for Baltimore City that 75% of eligible investments within RISE zones are located within an enterprise zone, 10% within a focus area, and the remaining 15% are not located within an enterprise zone. Average county assumes 10% within an enterprise zone, 5% within a focus area, and the remaining 85% are not located within an enterprise zone. State savings reflects a total of $10 million in annual investments, half of which are within Baltimore City.

Local Income Tax

Local highway user revenues distributed to Baltimore City, counties, and municipalities will decrease as a result of income tax credits and additional depreciation claimed against the corporate income tax. In addition, local income tax revenues will decrease as a result of additional depreciation amounts claimed against the local income tax. Exhibit 3 shows the potential decrease in local income tax revenues and local highway user revenues due to additional depreciation.

Small Business Impact: Small businesses located in an area designated as a RISE zone under the bill will potentially benefit from decreased property and income tax burdens. Conversely, any small businesses that are competitors of these businesses and do not qualify will be at a competitive disadvantage due to higher relative tax burdens.

Additional Information

Prior Introductions: None.

Cross File: SB 600 (Senator Pugh, *et al.*) - Budget and Taxation.

Information Source(s): Department of Business and Economic Development, Comptroller's Office, Maryland Association of Counties, Maryland Department of Transportation, Department of Legislative Services

Fiscal Note History: First Reader - March 4, 2014
mc/jrb

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