HB 531

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

House Bill 531 (Delegate Beidle, *et al.*)
Ways and Means

Maryland Strong Manufacturing Development Act

This bill establishes the Manufacturing Development (MD) Zone Program, to be administered by the Department of Commerce. Counties and municipalities may apply for designation of an area as a MD zone. A qualified business engaged in manufacturing that locates in a zone is entitled to a 10-year (1) property tax credit for local real and personal property taxes and (2) income tax credit for 100% of the qualified income attributable to the qualifying manufacturing facility. The bill also exempts from the State income tax the qualified wages and salaries paid to certain employees employed by qualifying manufacturing entities within a zone.

The bill takes effect June 1, 2016. The property tax credit provisions apply to all taxable years beginning after June 30, 2016, and the income tax provisions apply to all taxable years beginning after December 31, 2016.

Fiscal Summary

State Effect: State revenues may decrease significantly due to income tax credits claimed by qualifying business entities and an exemption from income tax for wage and salary income of certain qualifying employees. General fund expenditures may increase beginning in FY 2017 due to implementation costs.

Local Effect: Real and personal property tax revenues in counties and municipalities in which a zone is designated may decrease significantly. Local income tax revenues and local highway user revenues will decrease due to income tax credits claimed against the income tax and the exemption of specified wage and salary income. Local expenditures may increase minimally to administer the program.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The MD zone program provides income tax and property tax incentives to qualifying manufacturing businesses within a geographic area designated as a MD zone by the Department of Commerce. Counties and municipalities may submit an application for an area to be designated as a zone as described below. A business qualifies if it (1) operates or conducts a trade or business that is engaged in heavy manufacturing; (2) makes a capital investment or increases employment; (3) does not have a presence in the State prior to locating in the zone; and (4) meets the requirements specified for each incentive.

The Department of Commerce and the Comptroller must assess the effectiveness of the tax credits and report specified information about the program by December 15 of each year to the Governor and the General Assembly.

Zone Designations

Counties and municipalities may apply to the Secretary of Commerce to designate an area as a MD zone, and the application must contain specified information including (1) the standards that a business entity must meet before qualifying for the program; (2) whether the county or municipality has examined the feasibility of creating applicable educational or training programs; and (3) the methods that will be used to target and attract businesses.

The Secretary of Commerce must submit each application to the Maryland Advisory Commission on Manufacturing Competitiveness, which is required to approve or reject an application within 30 days. Based on the commission's approval, the Secretary of Commerce may (1) designate a MD zone; (2) designate up to six zones in a calendar year; and (3) approve up to two zones in a county within the same calendar year. MD zone designations are effective for 10 years. The bill also establishes the criteria for expanding an existing zone.

Program Incentives

The Department of Commerce may award incentives to a qualifying manufacturing business that (1) moves into or locates in a MD zone on or after the date that the zone is designated and creates jobs or makes a qualifying capital investment or (2) is located within the zone prior to designation if the business entity makes a capital investment or expansion of its labor force after a zone is designated. A business may not qualify for program incentives unless (1) the county or municipality in which the zone is located certifies that the business has complied with local standards; (2) the business conducts its trade on real property it owns within the zone; and (3) the Secretary determines that the business entity is engaged in a manufacturing trade or business and did not have an economic presence in the State prior to locating in the zone.

A qualifying manufacturing business must be engaged in heavy manufacturing. The bill defines heavy manufacturing as a manufacturing process that involves large scale projects and includes construction, mining, and metal processing and excludes the processing, fabrication, assembly, or disassembly of apparel, decorations, electronic devices, food, home accessories, instruments, jewelry, leather, paper, or textiles.

A qualifying business may apply for a 10-year (1) property tax credit for 100% of local real and personal property taxes imposed on a qualified property of a manufacturing business; (2) income tax credit for 100% of the qualified income attributable to the qualifying manufacturing facility; and (3) consideration for assistance from Department of Commerce financial assistance programs, if the Secretary of Commerce determines that the business creates jobs. These programs include the Maryland Economic Adjustment Fund, Maryland Economic Development Assistance Authority and Fund, Maryland Industrial Development Financing Authority, and the Maryland Small Business Development Financing Authority.

In addition, the wages and salaries paid to the employees of the qualifying manufacturing facility are exempt from State and local income taxes, if the qualified income is attributable to the activities in the manufacturing zone and the total income of an employee in the taxable year is less than $65,000.

Property Tax Credits

A local government must grant a property tax credit against local real property taxes imposed on the eligible assessment of qualified property owned by an eligible business entity. Qualified property is real property that is not used for residential purposes, used in a manufacturing trade or business by a business entity, and located in a MD zone. State property taxes imposed on real property are not affected.

The amount of the property tax credit is equal to 100% of the assessment increases resulting from the value of real property improvements, which is calculated by the State Department of Assessments and Taxation (SDAT). Property tax credits can be claimed for 10 taxable years.

The Secretary of Commerce 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 properties became qualified properties. SDAT must submit to the Department of Commerce specified information regarding the qualified properties.

In addition, local governments must grant a 10-year credit against 100% of the personal property taxes imposed on eligible property that is used in a manufacturing trade and primarily located on real property that is granted a property tax credit under the program.

Income Tax Incentives

A qualified business entity may claim a tax credit against the State income tax for 100% of the income attributable to activities at a manufacturing facility located in a MD zone. A qualified business entity must be engaged in a manufacturing trade or business and be eligible for a real property tax credit under the program. The income tax credit may be claimed for up to 10 taxable years beginning with the taxable year following the calendar year in which the business property becomes eligible for a property tax credit.

The bill exempts 100% of the wages and salaries paid to employees of a qualifying manufacturing facility if (1) the qualified income is attributable to activities at a manufacturing facility located in a MD zone and (2) the business entity meets the qualifications of the program and is eligible for the real property tax credit established by the program. The exemption does not apply to an individual who during the taxable year has more than $65,000 in qualified income.

Current Law/Background: Numerous federal and State incentives are available to manufacturing businesses. These programs include similar zone-based programs available to businesses in different types of industries and specific incentives targeted to manufacturing businesses. These incentives include:

- the Enterprise Zone Program;
- the One Maryland Program; and
- single sales factor apportionment for qualifying manufacturers.

Enterprise Zone Property Tax Credits

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. The Secretary of Commerce 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 one-third of all enterprise zones have businesses that are concentrated within manufacturing, fabrication, transportation, warehousing, distribution, and research and development. This concentration typically results from either enterprise zone local standards restricting credit eligibility to these activities and industries or the establishment of the zone within an industrial or business park that has similar requirements.

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 report issued in August 2014. 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.

- **The Department of Commerce, 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. DLS evaluation of the enterprise zone tax credit can be found here.

One Maryland Program

The One Maryland economic development tax credit was established to assist businesses with the costs of economic development projects undertaken in qualified economically distressed counties, and specifically to encourage capital investment and job creation in those counties. A business in a qualifying industry that establishes or expands a business facility in a priority funding area, and is located in a qualified distressed county, may be entitled to an income tax credit of up to $5.5 million.

From calendar 2001 through 2010, businesses within the manufacturing industry claimed the largest amount of credits – of the 54 projects that received a total of $222.5 million in credits under the program, 18 were manufacturing projects that were awarded a total of $79.6 million in credits. Projects located in areas other than Baltimore City had a higher concentration of projects within the manufacturing industry, as these projects claimed the majority of credits in these counties.

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. These are in addition to State business assistance programs that provide loans and grants or develop property for business use. Local governments have also established and expanded the use of financial assistance, job creation, and economic development tax credits; tax increment financing; payment-in-lieu-of-taxes agreements; 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 evaluation of the One Maryland tax credit, issued in August 2014, 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.

DLS evaluation of the One Maryland tax credit can be found here.

Single Sales Factor Apportionment

Corporations engaged in multistate operations are required to determine the portion of their modified income attributable to Maryland, based on the amount of their trade or business carried out in Maryland. Corporations are generally required to use a three-factor apportionment formula of payroll, property, and sales, with sales double weighted. Chapter 633 of 2001 specified that qualifying manufacturing corporations allocate income to Maryland based on a single-factor formula consisting solely of sales. The Comptroller's Office estimates that the special allocation of income for manufacturers decreased tax year 2010 corporate income tax revenues by $21.4 million. This loss equates to a reduction of about 14% of the $154.3 million tax year 2010 liability of all manufacturers (excluding refiners, who are exempt from using single-sales apportionment), and about 2.7% of total corporate income tax liability.

State Employment Trends and Manufacturing Employment

In the second quarter of 2015, Maryland manufacturing businesses employed a total of 103,909 workers, about 4% of Maryland's total nonfarm employment. A small percentage of Maryland manufacturing businesses are engaged in heavy manufacturing – 30 of the 3,650 Maryland manufacturers were engaged in metal processing, and these businesses employed a total of 934 people. Maryland construction, logging, and mining industries employed a total of 153,500 workers or 6% of total Maryland nonfarm employment. Most of these businesses were in the construction industry as a total of 1,280 people were employed by 98 businesses within the mining, quarrying, and oil and gas extraction industry. Within the construction industry most employment is for specialty trade contractors and/or the construction of homes. A total of 862 heavy and civil engineering construction companies employed 16,090 people.

Changes in employment over time reflect the net impact of many factors, including shorter-term impacts such as recessions as well as long-term trends impacting the demand for products within industries and technological changes. These trends often differ across industries as the Maryland and national economies have shifted away from goods producing industries to service economies. The share of the U.S. employed within manufacturing and agriculture since World War II has declined from about one-third to a little more than 10%. Employment within the services industry doubled from about one-quarter to one-half. Although manufacturing employment has fell within the United States, output continues to increase reflecting more widespread use of technology that increases productivity. The manufacturing industry's share of the Maryland economy (about 8%) is about double its share of total employment and the industry remains the second largest source of corporate income tax revenues.

Since 1990, total Maryland nonfarm employment has increased by 432,300 or about one-fifth. Most of this increase has been driven by growth in the education and health services and professional and business services industries. Employment within these industries increased by 371,100 since 1990, and businesses within these industries employ one out of every three people in the State. Conversely, since 1990 employment within the construction, logging, and mining and manufacturing industries has fell by 104,400. **Exhibit 1** shows the change in Maryland employment by sector since 1990.

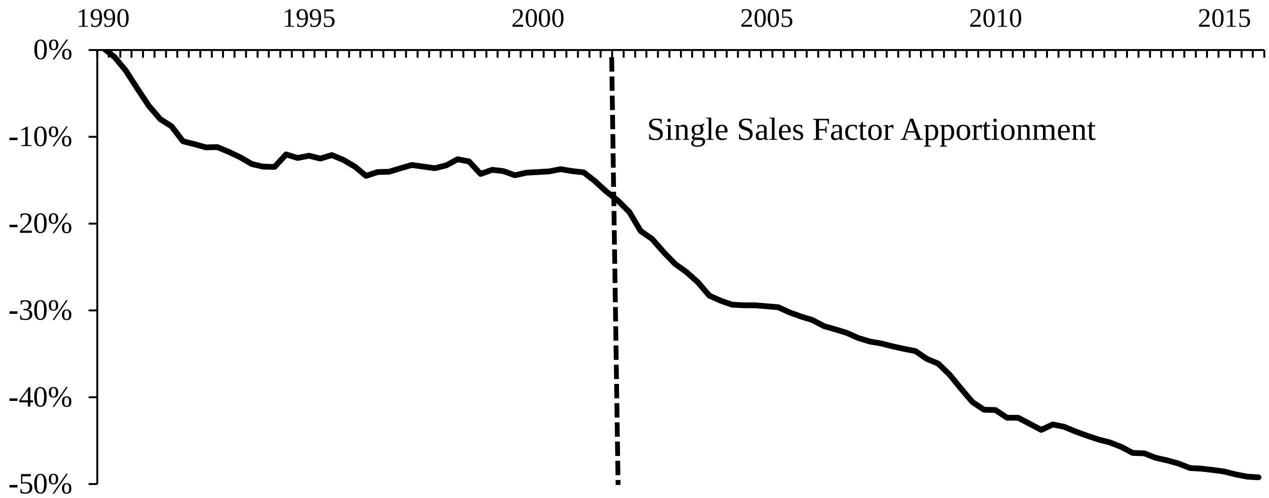
Exhibit 1
Maryland Employment by Sector
1990-2015

Employment Sector	1990	2000	2015	% Change
Construction, Logging, and Mining	163,700	158,000	153,500	-6.2%
Manufacturing	198,100	172,100	103,900	-47.6%
Trade, Transportation, Utilities	447,000	465,900	455,300	1.9%
Information	47,400	56,900	38,700	-18.4%
Financial Activities	136,100	146,000	139,000	2.1%
Professional and Business Services	255,800	363,000	430,800	68.4%
Education and Health Services	221,800	302,500	417,900	88.4%
Leisure and Hospitality	184,000	201,900	275,600	49.8%
Other Services	96,500	112,600	91,600	-5.1%
Government	420,400	447,600	496,800	18.2%
Total Nonfarm Employment	**2,170,800**	**2,426,500**	**2,603,100**	**19.9%**

Source: U.S. Bureau of Labor Statistics, Department of Legislative Services

Exhibit 2 shows the cumulative change in quarterly employment within the Maryland manufacturing industry from 1990 to the first quarter of 2015. Exhibit 2 also shows when multi-state manufacturers were required to apportion income based on a single-sales factor. Despite this measure intended to spur economic growth and employment in the industry, total employment continued to decline, reflecting the influence of recessions and technological, national and international economic influences impacting the industry. Employment fell by 26,000 from 1990 to 2000 and by 68,000 in 2000 through 2010. Manufacturing losses have accelerated since 2000 – annual losses increased from 1.6% in 1990 to 2000 to 3.3% since 2000.

Exhibit 2
Cumulative Change in Maryland Manufacturing Employment
1990-2015



Source: U.S. Bureau of Labor Statistics, Department of Legislative Services

State Revenues: State revenues will decrease as a result of income tax credits claimed by qualifying manufacturers. In addition, the bill exempts from the State income tax wages and salaries paid to certain employees of a qualifying manufacturing facility.

The amount of the State revenue loss depends on the number and size of the zones, the locations of the zones, the number of employees eligible for the income tax exemption, and the amount of qualifying business activity that occurs in each zone. There is no limitation on the total number of zones that can be designated or the size of the zones. In addition, revenue losses will occur based on the type of businesses that qualify for the program. There are a limited number of heavy manufacturers in the State but an unknown number of construction businesses that are engaged in large-scale projects that may qualify for the tax credits. Given that the bill exempts 100% of the income attributable to a qualifying manufacturing entity, the revenue loss per qualifying entity could be significant.

State Expenditures: General fund expenditures increase in fiscal 2017 due to implementation costs at the Comptroller's Office, as described below. In addition, State expenditures may decrease due to a savings in State enterprise zone reimbursements.

The Comptroller's Office reports that it will incur a one-time expenditure increase of $92,000 in fiscal 2017 to add the business tax credit. This amount includes data processing changes to the SMART income tax return processing and imaging systems and systems testing. The Comptroller's Office also reports it will incur additional expenditures to conduct (1) additional compliance and tax return processing and (2) an assessment of the credit's effectiveness. In addition, general fund expenditures may increase at SDAT due to additional expenditures incurred from calculating property tax credits.

Property Tax Reimbursements

Qualifying businesses within MD zones can claim both the property tax credits proposed by the bill and enterprise zone tax credits. To the extent the zones overlap and businesses claim MD property tax credits, State reimbursements 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.

Local Revenues: Property tax and local income tax revenues will decrease in counties and municipalities in which a MD zone is designated. In addition, local highway user revenues distributed to local governments will decrease as a result of credits claimed against the corporate income tax and local income tax revenues will decrease due to the exemption of qualified wage and salary income of manufacturing employees. Each of the impacts is discussed below.

Property Tax

Real and personal 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 MD 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. 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 jurisdictions, as is the cost since the Baltimore City property tax rate is significantly higher than other jurisdictions.

Local Income Tax and Local Highway User Revenues

Local income tax revenues will decrease due to the exemption of certain wages and salaries paid to the employees of the qualifying manufacturing facility. In addition, local highway user revenues distributed to Baltimore City, counties, and municipalities will decrease as a result of income tax credits claimed against the corporate income tax.

Small Business Impact: Small businesses located in an area designated as a 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: SB 507 of 2015 was referred to interim study by the Senate Budget and Taxation Committee.

Cross File: SB 181 (Senator Manno, *et al.*) - Budget and Taxation.

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

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