

**Department of Legislative Services**  
2012 Session

**FISCAL AND POLICY NOTE**

Revised

House Bill 1248

(Delegate Ross, *et al.*)

Ways and Means

Budget and Taxation

**Income Tax Credit - Security Clearances - Employer Costs**

This bill creates a tax credit against the State income tax for certain qualified costs incurred by a business to (1) obtain security clearances for its employees located in the State; and (2) construct or renovate a sensitive compartmented information facility located in the State. The Department of Business and Economic Development (DBED) is required to administer the tax credit and is authorized to award a maximum of \$2.0 million in credits each year. The credit may be claimed in tax years 2013 through 2016.

The bill takes effect July 1, 2012, and terminates June 30, 2016.

**Fiscal Summary**

**State Effect:** General fund revenues decrease by \$1.6 million in FY 2015, which reflects the applicability of the credit under the bill. Transportation Trust Fund (TTF) revenues decrease by \$0.3 million and Higher Education Investment Fund (HEIF) revenues decrease by \$0.1 million in FY 2015. General fund expenditures increase by \$0.2 million in FY 2014 for implementation costs at DBED and one-time tax form changes and computer expenses at the Comptroller’s Office. Future years reflect the maximum amount of credits authorized each year and ongoing administrative costs at DBED.

| (\$ in millions) | FY 2013 | FY 2014 | FY 2015 | FY 2016 | FY 2017 |
|------------------|---------|---------|---------|---------|---------|
| GF Revenues      | \$0     | \$0     | (\$1.6) | (\$1.6) | (\$1.6) |
| SF Revenues      | 0       | 0       | (0.4)   | (0.4)   | (0.4)   |
| GF Expenditure   | 0       | 0.2     | 0.1     | 0.1     | 0.1     |
| Net Effect       | \$0     | (\$0.2) | (\$2.1) | (\$2.1) | (\$2.1) |

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

**Local Effect:** None.

**Small Business Effect:** Minimal.

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## **Analysis**

**Bill Summary:** The bill creates a tax credit against the State income tax for certain security clearance administrative expenses and for the costs to construct or renovate a sensitive compartmented information facility located in the State as required by the federal government. In order to qualify, the security clearance administrative expenses must be incurred with regard to an employee in the State and include (1) processing application requests for clearances; (2) maintaining, upgrading, or installing computer systems in the State that are required to obtain federal security clearances; and (3) training employees to administer the application process.

The amount of the credit for security clearance administrative expenses is equal to 100% of eligible expenses, not to exceed \$100,000. The amount of the credit for sensitive compartmented information facility expenses is equal to 50% of eligible expenses, not to exceed \$100,000 for a single qualifying facility or \$250,000 for multiple qualifying facilities. Any unused amount of the credit can be carried forward until the full amount of the excess is used. DBED is authorized to award a maximum of \$2.0 million in total credits each year.

DBED, in consultation with the Comptroller, is required to adopt regulations to implement the credit and specify costs eligible for the credit and also report specified credit information to the Governor and General Assembly by December 31 of each year.

**Current Law:** Security clearance expenses are typically counted as a business expense and are deducted from State tax liability. An individual that itemizes deductions can also typically deduct any security clearance expenses incurred during the year.

**Background:** Federal security clearances are commonly required for employment by or for contractors in a variety of national defense, intelligence, and law enforcement agencies, as well as other government agencies. The Federal Investigative Services of the Office of Personnel Management (OPM) provides personnel background investigative services to determine individuals' suitability for federal civilian, military, and contract employment and eligibility for access to classified national security information. Background investigations are performed for federal agencies on a fee-for-service basis that are financed by payments from other agencies through the use of a revolving fund. OPM's federal fiscal 2012 budget request included an estimated \$1.9 billion in funds financed by other agencies' funds.

OPM states that it conducts more than 90% of the federal government's background investigations of federal employees, contractors, and military members of various federal agencies. OPM also conducts national agency check and inquiry cases and background security/suitability investigations for federal agencies on a reimbursable basis through the use of the revolving fund. OPM expects to complete over 2 million investigations in federal fiscal 2012.

The majority of OPM's security clearances are conducted on behalf of the Department of Defense and Department of Homeland Security. In the first quarter of federal fiscal 2010, 4.5% of investigations were conducted by intelligence community agencies, which includes the NSA, CIA, Defense Intelligence Agency, FBI, National Geospatial-Intelligence Agency, National Reconnaissance Agency, and Department of State. During the same period, 1.2% of all other investigations were conducted by other agencies, including the U.S. Customs and Border Protection, U.S. Coast Guard, and US AID.

The Fiscal Year 2010 Intelligence Act established requirements for an annual report on the volume, timeliness, and quality of security clearance investigations as well as outlining the number of security clearance determinations due to ongoing congressional concerns about the timeliness of security clearances, which have been identified in numerous reports as a significant barrier to national security operations. According to published reports, this was the first time that the federal government produced a detailed accounting of the clearances issued to federal, military and contract employees and the total number of clearances far exceeded previous estimates. **Exhibit 1** shows the number of individuals with a federal security clearance as of October 2010. In federal fiscal 2010, a total of 642,831 new clearances were approved. During this same time, approximately 597,800 security clearances were terminated due to retirement, change of job, or revocation.

Given its proximity to the nation's capital, a number of Marylanders work for government agencies that require a security clearance or are contractors that are part of the national security community. Some of the 16 federal government intelligence agencies with a local presence include the Defense Intelligence Agency, National Security Administration, Department of Defense, and various military installations including the Pentagon, the Central Intelligence Agency, the National Reconnaissance Office, the National Geospatial-Intelligence Agency, the Department of Homeland Security, and the Department of Justice. In addition to these large agencies, a number of government organizations and private companies work on programs related to counterterrorism, homeland security, and intelligence in locations across the United States and in the Washington, DC area. As part of a two-year investigation of the recent proliferation of intelligence activities, the *Washington Post* estimated that in 2010 there were 1,271 of these government organizations and 1,931 private companies in

10,000 locations across the United States. The *Washington Post* also estimated that 33 complexes for top-secret intelligence work, occupying about 17 million square feet of office space, are under construction or have been built in the Washington, DC area since September 2001.

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**Exhibit 1**  
**Number of Individuals with a Federal Security Clearance**  
**October 2010**

|                      | <u>Confidential/Secret</u> | <u>Top Secret</u> | <u>Total</u>     |
|----------------------|----------------------------|-------------------|------------------|
| Government Employees | 2,166,679                  | 666,008           | 2,832,687        |
| Contractors          | 541,097                    | 524,990           | 1,066,087        |
| Other/Unknown        | 139,264                    | 228,053           | 367,317          |
| <b>Total</b>         | <b>2,847,040</b>           | <b>1,419,051</b>  | <b>4,266,091</b> |

Source: *Annual Intelligence Authorization Act Report on Security Clearance Determinations for Fiscal Year 2010*, Office of the Director of National Intelligence

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Other government agencies that may require security clearances include the U.S. Department of State, the U.S. Drug Enforcement Agency, and Department of Treasury.

A sensitive compartmented information facility is an area, room, or group of rooms where sensitive or classified information may be stored or processed.

**State Fiscal Effect:** DBED is authorized to award a maximum of \$2.0 million in credits each year. Although tax credits may be claimed beginning in tax year 2013, DBED must certify the amount of eligible expenses incurred before the tax credit may be claimed. DBED certifies expenses on December 15 of the calendar year following the end of the taxable year in which the qualifying expenses occurred. A business must then file an amended return to claim the credit – it is assumed that the earliest this could be done is in fiscal 2015 and that companies do not adjust estimated payments. As a result, general fund revenues decrease by \$1.6 million, TTF revenues decrease by \$0.3 million, and HEIF revenues decrease by \$0.1 million in fiscal 2015.

To the extent that companies adjust estimated payments in anticipation of earning credits, revenue losses will occur in fiscal 2014.

It is assumed that the maximum amount of credits is awarded in each fiscal year. Given that OPM conducts 90% of all federal security clearances for employees and contractors

and that costs are reimbursed by other federal agencies, the actual amount of credits awarded in each year may be significantly less.

### *Administrative Expenses*

DBED advises that it would incur additional costs beginning in fiscal 2014 as a result of hiring a full-time tax specialist to administer the credit and satisfy the bill's reporting requirements. As a result, special fund expenditures could increase by \$97,000 in fiscal 2014. It includes a salary, fringe benefits, and ongoing operating expenses.

|  |                 |
|--|-----------------|
| Contractual Position                   | 1               |
| Salary and Fringe Benefits             | \$91,940        |
| Operating Expenses                     | <u>5,041</u>    |
| <b>Total FY 2014 DBED Expenditures</b> | <b>\$96,981</b> |

The Comptroller's Office reports that it would incur a one-time expenditure increase of \$80,000 in fiscal 2014 to add the tax credit to the personal and corporate income tax forms. This includes data processing changes to the SMART income tax return and processing systems, and systems testing.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 296 (Senator Manno, *et al.*) - Budget and Taxation.

**Information Source(s):** Department of Business and Economic Development, Comptroller's Office, General Accounting Office, Office of the Director of National Intelligence, Office of Personnel Management, Department of Legislative Services

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