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BILL ANALYSIS

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Senate Bill 350 (Substitute S-2 as passed by the Senate)
Senate Bill 351 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Bill Schuette (Senate Bill 350)
Senator Joanne G. Emmons (Senate Bill 351)
Committee: Economic Development, International Trade, and Regulatory Affairs

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RATIONALE

Michigan has done much recently to reduce the costs of doing business in the State and to improve a business climate that many apparently consider to be unfavorable for economic development. Some say, however, that not enough has been done to attract businesses to Michigan and to encourage businesses already here to stay and expand. According to the Michigan Jobs Commission, which commissioned PHH Fantus Consulting to study the economic climate of Michigan and its major competitors (i.e., Wisconsin, Indiana, Ohio, Kentucky, North Carolina, South Carolina, and Alabama), most government-driven costs in competing states are lower than those in Michigan, including workers' compensation costs, unemployment insurance costs, and business taxes. Further, the competing states reportedly have structural cost advantages over Michigan, including lower labor costs, subsidized utility rates from the Federal government, and lower pollution control requirements. Finally, they apparently offer some of the most substantial economic development incentives in the nation. In fact, Michigan reportedly is one of only six states that do not have some form of job creation tax incentive. According to various sources, competition for the jobs created by economic expansion projects is fierce and only expected to escalate. Reportedly, some of the other states are so aggressive that their programs allow an investing company literally to recoup its entire capital investment costs through breaks in corporate income taxes, and other incentive offerings. The competition, although it has repercussions throughout the State, may be most keenly felt by Michigan's border counties that compete daily with Indiana and Ohio to attract and retain businesses. Most recently, Michigan lost an ALCOA project and a North Star-BPH Steel project to Ohio because, according to some, this State could not compete with Ohio's tax incentive program for business. (See BACKGROUND.) If Michigan is to be able to capture a larger market share of the growth of Michigan-based firms as well as compete more favorably for investments from out-of-state business, some believe that the State must have some type of tax incentive program to use as an inducement for the businesses.

CONTENT

Senate Bill 351 (S-2) would create the "Michigan Economic Growth Authority Act" and establish the Michigan Economic Growth Authority (MEGA) within the Michigan Jobs Commission to determine which businesses would be eligible to receive single business tax (SBT) credits based on the number of new jobs they created. Senate Bill 350 (S-2) would amend the Single Business Tax Act to provide for single business tax credits for businesses authorized by MEGA to receive the credits.

Following is a detailed description of the bills.

Senate Bill 351 (S-2)

Authorized Business Designation

The bill would allow an eligible business to apply to MEGA for determination as a authorized business if it created a minimum of 75 qualified new jobs if it were expanding in this State, or 150 qualified new jobs if it were locating in this State, within 12 months of opening the facility. ("Eligible business" would mean a business that proposed to create qualified jobs in Michigan after the effective date of the bill in manufacturing, mining research and development, wholesale and trade, or office operations. An eligible business would not include a retail establishment, professional sports stadium, or that portion of an eligible business used exclusively for retail sales. "Qualified new job" would mean a full-time job created by an authorized business at a facility that was in excess of the number of full-time jobs the authorized business maintained prior to the expansion or location, as determined by the authority. "Facility" would mean a site within this State in which an authorized business created new jobs.) After receiving an application, MEGA could determine that an eligible business was an authorized business and could enter into an agreement with it for a tax credit, if MEGA determined that all of the additional following criteria were met:

-- The eligible business agreed to maintain a minimum of 75 qualified new jobs if it were expanding in this State, or a minimum of 150 qualified new jobs if it were locating in this State for each year that an SBT credit was authorized.
-- In addition to the requisite minimum number of jobs, the eligible business, if expanding, agreed to maintain a number of full-time jobs equal to or greater than the number it maintained in this State prior to the expansion, as determined by MEGA.
-- The average wage paid for all qualified new jobs equaled or exceeded 150% of the Federal minimum wage.
-- The expansion or location of the eligible business would not have occurred in this State without the tax credits offered under the bill.
-- The local governmental unit in which the eligible business would expand or be located, or a local economic development corporation or similar entity, would make a financial or economic commitment to the eligible business for the expansion or location.
-- The financial statements of the eligible business indicated that it was financially sound and that its plans for the expansion or location were economically sound.
-- The eligible business had not begun construction or publicly announced a specific location of the facility.
-- The expansion or relocation of the eligible business would benefit the people of this State by increasing opportunities for employment and by strengthening the State's economy.
-- The tax credits were an incentive to expand or locate the eligible business in Michigan and address the competitive disadvantages with sites outside this State.
-- A cost-benefit analysis revealed that authorizing the eligible company to receive tax credits would result in an overall positive fiscal effect on the State.
-- If feasible, as determined by MEGA, in locating the facility, the authorized business reused or redeveloped property that was previously used for an industrial or commercial purpose.

If MEGA determined that the criteria were met, it would have to determine the amount and duration, up to 20 years, of the tax credit to be authorized. In determining the amount and duration of the credits, MEGA would have to consider the following factors:

-- The number of qualified new jobs to be created.
-- The average wage level of the qualified new jobs created relative to the average wage paid by private entities in the county in which the facility was located.
-- The total capital investment the eligible business would make.
-- The cost differential to the business between expanding or locating in Michigan and a site outside of Michigan.
-- The potential effect of the expansion or location on the State's economy.
-- The cost of the credit, the financial or economic assistance provided by the local government unit, or local economic development corporation or similar entity, and the value of assistance otherwise provided by the State.

A written agreement between an eligible business and the Authority would have to include, but would not have to be limited to, all of the following:

-- A description of the business expansion or location that was the subject of the agreement.
-- The conditions upon which the authorized business designation was made.
-- A statement by the eligible business that a misrepresentation in the application or a violation of the written agreement could result in the revocation of the designation

and the loss or reduction of future credits or refund of credits received.
- -- A method for measuring full-time jobs prior to and after an expansion or location of an authorized business in this State.

Upon execution of a written agreement, an eligible business would be an authorized business eligible for single business tax credits provided by Senate Bill 351. The Authority would have to issue each year to an authorized business a certificate that stated that the taxpayer was an authorized business and specified the amount and duration of the tax credit for the authorized business for the designated tax year.

MEGA Membership and Duties

The eight-member Authority would consist of the Director of the Michigan Jobs Commission, who would be the chairperson, the State Treasurer, the Directors of the Departments of Management and Budget and Transportation, or their designees, and four other members, appointed by the Governor with the advice and consent of the Senate, who were not State employees and who had knowledge, skill, and experience in the academic, business, local government, labor, or financial field.

Members would be appointed for four-year terms, except that two of the members first appointed by the Governor would serve two-year terms. A vacancy would have to be filled for the balance of the unexpired term in the same manner as an original appointment. Except as otherwise provided by law, MEGA members could not be compensated for services, but MEGA could reimburse each member for expenses necessarily incurred in the performance of his or her duties.

The powers of MEGA would be vested in its members in office. Regardless of the existence of a vacancy, a majority of the members would constitute a quorum necessary for the transaction of business at a meeting or for the exercise of a power or function of MEGA. Action could be taken by MEGA at a meeting upon a vote of the majority of the members present. The Authority would have to meet at the call of the chairperson or as provided in its bylaws. Meetings could be held anywhere within this State.

The Michigan Jobs Commission would have to provide staff for MEGA and would have to carry out the administrative duties and functions as directed by MEGA. The budgeting, procurement, and related functions as directed by MEGA would be under the supervision of the Director of the Michigan Jobs Commission.

The Authority would be subject to the Open Meetings Act. A record or portion of a record, material, or other data received, prepared, used, or retained by MEGA in connection with an application for a tax credit that related to financial or proprietary information submitted by the applicant that was considered by him or her and acknowledged by MEGA to be confidential would not be subject to the disclosure requirements of the Freedom of Information Act. Further, MEGA could meet in closed session to determine whether it acknowledged as confidential any financial or proprietary information submitted by the applicant. Unless considered proprietary information, MEGA could not acknowledge routine financial information as confidential. The Authority could not disclose financial or proprietary information not subject to disclosure without the applicant's consent. "Financial or proprietary information" would mean information that had not been publicly disseminated or was unavailable from other sources, the release of which might cause the applicant significant competitive harm. Financial or proprietary information would not include a written agreement between MEGA and the applicant.

The Authority would have to report to both houses of the Legislature yearly on October 1 on its activities and provide a listing of all authorized businesses, the amount and duration of the tax credit for each authorized business, and the total cost of the tax credits issued.

The Authority would have the powers necessary or convenient to carry out and effectuate the purpose of the bill, including but not limited to, the power to:

- -- Authorize eligible businesses to receive tax credits to foster job creation in this State.
- -- Determine which businesses qualified for tax credits and the amount and duration of those credits.
- -- Enter into written agreements specifying the conditions under which tax credits were authorized and the circumstances under which those tax credits could be reduced or terminated.
- -- Charge and collect an administrative fee to process an application not to exceed $500 per application.
- -- Delegate to the MEGA chairperson, staff, or others the functions and powers it deemed

necessary and appropriate to administer the program.

-- Assist an eligible business to obtain the benefits of a tax credit, incentive, or inducement program provided by the bill or by law.

-- Promulgate rules necessary to implement the bill.

Senate Bill 350 (S-2)

The bill would amend the Single Business Tax Act to provide for tax credits for businesses authorized by the Michigan Economic Growth Authority to receive the credits. Specifically, the bill provides that for tax years beginning after December 31, 1994, and for a period of up to 20 years as determined by MEGA, a taxpayer that was an authorized business could claim an SBT credit for the amount certified each year by MEGA, up to the amount of its payroll that was attributable to employees who performed qualified new jobs multiplied by the tax rate. If the SBT credit exceeded the tax liability of the taxpayer for the tax year, the excess would have to be refunded to the taxpayer. In addition, an affiliated group, a controlled group of corporations as defined by the Internal Revenue Code, or an entity under common control as defined by the Internal Revenue Code would be entitled to only one SBT credit annually for each certificate for each facility or expansion regardless of whether a combined return or a consolidated return was filed.

The bill further specifies that, for the same tax years plus any carryforward years allowed, an authorized business could claim an SBT credit equal to the tax liability attributable to authorized business activity. If the credit allowed for the tax year and any unused carryforward of the credit exceeded the taxpayer's tax liability for the tax year, the excess amount could not be refunded, but could be carried forward to offset tax liability in subsequent tax years for 10 years or until it was exhausted, whichever occurred first. The tax liability attributable to authorized business activity would be the tax liability imposed by the Act after the calculation of the small business, charitable contributions, public utility, and unincorporated and Subchapter S credits multiplied by a fraction whose numerator was the ratio of the value of the facility to all property located in this State plus the ratio of payroll attributable to qualified new jobs to all payroll in this State, and whose denominator was two.

The bill would prohibit a taxpayer from claiming either of the proposed SBT credits until MEGA had issued a certificate to the taxpayer. The taxpayer would have to include the certificate with the tax return on which an SBT credit was claimed. Neither credit could be claimed if the taxpayer's initial certification were issued after December 31, 1998.

Proposed MCL 208.37c & 208.37d (S.B. 350)

BACKGROUND

Jackson County recently lost a bid for a state-of-the-art auto parts facility planned by the Aluminum Company of America (ALCOA) despite a $5 million incentive package to locate there. Many of those involved in the negotiation process with ALCOA believe that the project will be locating in Toledo, Ohio, because Ohio gave the company a $500,000 annual tax advantage that Michigan could not offer since it does not have a tax-incentive program in place. According to a letter from the Jackson Alliance for Business Development (3-9-95) and an article in the Jackson Citizen Patriot (1-12-95), the project would have involved an initial investment of $30 million, initial employment of 120 individuals, initial payroll of $4.5 million, the possibility of a "sister" facility on the same site within five years, and about $291,000 in annual property taxes, after full tax abatement. An additional benefit that Jackson could have realized, according to the letter and the article, would have been international attention and the possibility of attracting support plants to the area. The ALCOA facility will be using a new high-tech process for molding large automotive assemblies, such as body frames, from steel.

The incentive package that Michigan offered to ALCOA included $2,835,000 in tax abatements (including full abatement of the State's six mills); $480,000 in State job training grants; 28 acres of improved industrial property offered by the Blackman Township Local Development Finance Authority, valued at $845,000, for a price of $100; a $750,000 Community Development Block Grant for road, water, and sewer extensions to serve the site; $50,000 in temporary office space while the plant was under construction; and relocation assistance for employees transferred to Jackson.

According to the Monroe County Industrial Development Corporation, Michigan lost another plant project to Ohio because Michigan's combined property and corporate tax burden greatly exceeded Ohio's tax structure. The North Star-BHP Steel project represented an investment of over $450 million, and 350 new jobs with an average wage of more than $13 per hour. According to one source, two more companies have located in Ohio since the North Star project moved there, increasing to about 500 the total number of new jobs at that site.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Michigan's pro-business orientation, highly skilled workers, expanding technological base, research universities, and continuing government initiatives to reduce business costs are not enough to compete with states that offer tax incentives to businesses to locate or expand within their borders. Indeed, many of Michigan's neighboring states have mounted aggressive campaigns to attract businesses, including those located in Michigan.

The bills would provide the State with the leverage it needs to attract the most promising commercial and industrial projects. The MEGA proposal would be a targeted, focused, and performance-based program that would be used only when all other State and local economic development resources were exhausted and there still existed a sizable cost differential with another state. The program would offer the State greater protection for its investment in attracting business and encouraging business expansion than did previous tax incentive programs. Instead of offering businesses tax abatements up front, the tax incentives in the bills would take effect only after a business had located or expanded in Michigan and created and maintained a minimum number of jobs. Wages for the project would have to be above the average county wage rate. Further, local financial participation would be required to demonstrate local support. The amount of incentives offered for any specific project would be determined by the MEGA board based on firm evaluation criteria and detailed cost/benefit studies, something few other states conduct for these programs. Based on individual circumstances, the evaluation also could include verification of an incentive offer from another state, a consultant's study of the company's competitiveness, and a detailed analysis of the project's operating costs. Finally, setting a 20-year maximum duration on the program would ensure that it did not assume a life of its own, but rather would be reviewed and evaluated based on its track record for encouraging economic development. In short, the bills would give the State a critical negotiating tool to convince businesses to locate and expand in Michigan, yet would provide sufficient safeguards to ensure that the businesses upheld their agreement to provide jobs and invest in the State.

Opposing Argument

According to an article in the Detroit News from the Mackinac Center (3-3-95), a 1988 report commissioned by the Michigan Senate Majority Leader, stated that "[t]he arguments against the conventional incentives approach to business development are overwhelming. Practically every major analysis conducted in the past decade has concluded that standard business incentives packages neither substantially encourage investment, nor boost output or create jobs..." The reason, according to the report, "is that the value of an incentive pales when compared with such locational factors as overall tax levels, a reasonably priced skilled labor force, the relative cost of bureaucratic compliance, efficient transportation facilities and general quality of life. If Michigan is not competitive in these areas, business will go elsewhere despite subsidies or credits."

The Wall Street Journal (3-17-95), states that, "... financial-inducement devices like MEGA ...[are] almost impossible to shut down, sunset clause or not. They ask political appointees to be good investment bankers, which they generally aren't. They make it more difficult to reduce overall tax rates. They reward one business at an implied cost to every other in-state enterprise, new or old. They encourage litigation by companies that are rejected for special treatment. They invite corruption. Voters (taxpayers) have no say... Such 'bribes' are a poor alternative to providing efficient and economic services, a minimalist-minded bureaucracy, and a well-prepared work force to every employer."

As these articles make clear, not only would the bills *not* be a panacea for Michigan's economic development woes, they could actually compound the State's problems.

Those states that aggressively pursue selective tax credit schemes to lure away business are actually reducing their ability to produce an overall, competitive business climate with each arbitrary subsidy or rebate contrivance they create. Michigan can foster superior and sustainable growth, as it is already proving, if it concentrates on improving its overall business climate. One suggestion for improving the general economic climate is to reduce the State's single business tax. The tax credits proposed by the bills, however, would reduce pressure for a reduction in the SBT rate by those firms that received the credits, and their costs would make it harder for the State to give up the revenue from a higher SBT rate.

Response: In assessing the effectiveness of previous tax incentive packages to promote economic development, one must beware of borrowing broadly from statistical theory and committing a "Type I" error. In such an error, the hypothesis--in this case, "Tax incentives help promote business development"--is actually true, but the implementation of measures to test the hypothesis is so poor and the results are so negative that the hypothesis is rejected. It may well be that tax incentives are very instrumental in encouraging job growth and economic development, but that other factors, such as political, instead of economic, decisions concerning the awarding of tax incentives or the absence of legal recourse, such as could be provided by written contracts, against businesses that did not fulfill their agreement to create new jobs led to the failure rate of previous tax incentive plans. The bills would address some of these factors by requiring written agreements between the State and the businesses receiving the tax credits; providing for tax credits to be given after a business created new jobs; and providing for the loss, reduction, and possible reimbursement of tax credits to the State by businesses that did not fulfill their obligations.

Opposing Argument

Programs such as those proposed by the bills put government in the position of choosing winners and losers from among competing businesses, a process that is best left to the markets and the free enterprise system.

Response: Governments of other states are already picking winners and losers by attracting Michigan companies and jobs to their states, making them the winners and Michigan the loser. About 44 states, including Ohio and Indiana, already have implemented similar programs and Wisconsin currently is considering doing so. Moreover, businesses have no qualms about picking winners and losers among states, local units of government, and even countries, by locating their facilities wherever it is most advantageous for them. Michigan must be able to compete with these challenges by having similar incentive programs to offer.

Opposing Argument

It would be a better use of time and money to seek changes that would improve the overall regulatory and tax climate of the State, which would benefit all Michigan businesses, rather than target relief to a selected few. Programs such as MEGA reward larger businesses and do little to help smaller firms.

Response: The programs do not necessarily benefit only the larger businesses. Many small firms go out of business or face severe economic hardship when a large employer leaves the State and takes jobs with it. When a new business expands or relocates in a community, small businesses in the area share in a substantial amount of the economic prosperity that results.

Opposing Argument

According to the Detroit News (3-15-95), the Michigan Citizens Research Council, in its analysis several years ago of the effect of targeted property tax abatements, found that those jurisdictions with low general property tax rates fared better economically than those jurisdictions that relied on the abatements to foster economic development. For example, low-tax Grand Rapids is growing at a much faster rate than high-tax Detroit. A firm in a high-tax locale that threatens to move out of State may be responding more to that locale's circumstances than to the statewide business climate; a MEGA tax credit simply would reward the high tax jurisdiction, thus sending the wrong signal to those areas that have kept their taxes under control.

Opposing Argument

MEGA would increase the size and cost of Michigan government. The proposal would authorize staff of the Michigan Jobs Commission to handle the administrative work involved in promulgating MEGA guidelines and rules, evaluating company applications, publishing an annual report, and performing other program oversight.

Opposing Argument

MEGA would set an unwelcome precedent for discretionary tax policy. The MEGA proposal, while calling for cost-benefit analysis of each application for credit, still would give an eight-member board of political appointees broad discretion to determine tax policy for some of Michigan's largest corporations. Although the proposed MEGA legislation would set no limit on the amount of tax credits that could be granted, the Jobs Commission proposes about $8 million per year. These 20-year credits would add up each year; after 10 years of such a program, the State would be forgoing SBT revenue of $80 million--high stakes for the subjective determination of an unelected board. At the very least, the duration of the tax credits should be reduced from 20 years to 10 years, there should be a limit on the number of projects or dollar amount of the credits given, and composition of the MEGA board should ensure that businesses were adequately represented and the board members made decisions based on sound economic and financial analysis, not on political expediency.

Opposing Argument

According to the Legislative Service Bureau (LSB), Senate Bill 351 could violate the Commerce Clause of the U.S. Constitution. As the LSB notes, "Section 2 of Substitute (S-2) for Senate Bill No. 351 states that the purpose of the legislation is 'to promote economic growth and to encourage private investment, job creation, and job upgrading.' Notwithstanding that statement, the purpose of section 8 of the substitute is to protect businesses that have an in-state presence over those with an out-of-state presence, if all other factors are even, by providing an easier way for the former businesses to gain both tax credits and an economic advantage over other businesses solely because the latter businesses have no in-state presence. As such, the legislation could be found to violate the Commerce Clause on its face. *See* Penn Mutual Life Ins Co. v Dep't of Licensing and Regulation, 162 Mich App 123, 130 (1987), in which the Court of Appeals noted that the United States Supreme Court, in cases such as Metropolitan Life Ins Co v Ward, 470 US 869 (1985), has consistently held that 'promoting domestic business within a state by discriminating against foreign [business is not a] legitimate state purpose.'

"Even if, however, the provision in Substitute (S-2) for Senate Bill No. 351 is not found to be invalid on its face, it is likely to be found to be invalid under the balancing test created by the courts. The legislation would place a significant burden on businesses with only an out-of-state presence in competing with businesses with an in-state presence, as the former businesses would be permitted a tax credit and, thus, a competitive advantage by merely creating 75 jobs, while the latter businesses would not get such a credit for creating 75, or even 149, new jobs. The extent of the burden is difficult to gauge as the package of bills of which Senate Bill No. 351 is a part permits the credit to be of up to 20 years duration and of a presently incalculable amount as there is no upper limit placed on the dollar amount of the payroll on which the credit would be partially based.

"In addition, the differential treatment of businesses with an in-state presence and those without such a presence does not appear to advance the purposes outlined in the legislation to a degree that outweighs the burden created by the differential treatment. The provision of 149, perhaps highly paid, new jobs by a business with only an out-of-state presence appears more likely to promote economic growth, encourage private investment, job creation, and job upgrading than the provision of 75, perhaps poorly paid, new jobs by a business with in-state presence. Therefore, it is likely that, even under the balancing test in Commerce Clause cases, the provision in Substitute (S-2) for Senate Bill No. 351, if enacted, would likely be found to violate the Commerce Clause."

Legislative Analyst: L. Burghardt

FISCAL IMPACT

It is not possible to estimate the direct impact these bills would have on State revenue with any degree of confidence because it it not known how many businesses would apply, qualify for, and be granted the tax credits proposed in these bills. However, to help put the potential fiscal impact of these bills in perspective, if it is assumed that 1) 30 contracts were issued each year, and 2) half of these were to in-state businesses that each created 75 new jobs and half were to out-of-state businesses that each created 150 new jobs, then these bills would reduce SBT revenue by an estimated $5.7 million during the first full year. By 1998, the last year that contracts could be granted, SBT revenue would be reduced by an estimated $26 million. If it is also assumed that these business expansions, and new jobs, would not occur without these special tax credits, then the State also would gain new income tax revenue from these new workers, which would partially offset the loss in SBT revenue. The net impact of these bills, after considering the revenue impacts on both the SBT and income tax, is an estimated $4 million loss for the first year and a $16 million reduction by 1998. If the average number of new jobs created by each business were double the minimum requirement needed to qualify for the proposed credits, then the estimated cost to the State would be double the above estimates.

The bills also would have an impact on local governments because portions of SBT and income tax revenues are shared with local governments as part of the revenue sharing program. Based on the above estimates, revenue sharing payments would increase by an estimated $0.1 million in the first full year, due to the increase in income tax revenue. In subsequent years, however, the net loss in State revenue would result in a net reduction in revenue sharing payments. It is estimated that in the second year, revenue sharing payments would decline by a net $0.5 million and by 1998, revenue sharing would decline by a net $3 million, based on the above estimates.

Senate Bill 351 (S-2) includes authorization for an Authority consisting of eight members to provide policy guidance for MEGA programs. Per diem compensation of the rate of $50 per day could require an appropriation of $20,000 annually, depending on how often meetings were convened. Staffing requirements could be provided for through current resources.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.