

Legislative Analysis



START-UP BUSINESS INCENTIVE PACKAGE

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House Bill 5331 as passed by the House
Sponsor: Rep. Lorence Wenke

Senate Bill 863 passed by the House
Sponsor: Sen. Bill Hardiman

House Bill 5335 as passed by the House
Sponsor: Rep. John Stakoe

Senate Bill 865 as passed by the House
Sponsor: Sen. Virg Bernero

House Bill 5341 as passed by the House
Sponsor: Rep. Matt Milosch

Senate Bill 867 as passed by the House
Sponsor: Sen. Gerald Van Woerkom

House Bill 5342 as passed by the House
Sponsor: Rep. Glenn Steil Jr.

Senate Bill 869 as passed by the House
Sponsor: Sen. Patricia Birkholz

House Bill 5343 as passed by the House
Sponsor: Rep. Scott Hummel

Senate Bill 872 as passed by the House
Sponsor: Sen. Bruce Patterson

House Bill 5345 as passed by the House
Sponsor: Rep. John Stakoe

Senate Bill 875 as passed by the House
Sponsor: Sen. Jud Gilbert, II

House Committees: Tax Policy
Commerce (Senate Bill 869 only)
Senate Committee: Economic Development, Small Business, and Regulatory Reform
First Analysis (5-18-04)

BRIEF SUMMARY: The bills would provide a qualified start-up business with a credit against or an exemption from various taxes. The credits would be conditioned on the business claiming a credit against the single business tax or the income tax.

FISCAL IMPACT: The fiscal impact of these bills would depend on the number of businesses that would qualify to claim a credit under HB 5331 and SB 863 and the degree to which local units approve of providing additional credits and exemptions under the remaining bills in the package. House Bill 5331 and SB 863 would reduce single business tax (SBT) revenue by an estimated \$2.0 million on an annual basis. Since all SBT revenue accrues to the General Fund/General Purpose (GF/GP), the fiscal impact would affect GF/GP revenue.

THE APPARENT PROBLEM:

During the most recent economic downturn and the subsequent (and protracted) “jobless recovery” the state has lost a significant number of jobs, particularly those in the manufacturing sector. It is estimated that the state has lost 185,000 manufacturing jobs

since 1999. For quite sometime now, the state has tried to transform itself from a traditional “rust-belt” state that is dominated by the manufacturing sector to a state that is a national leader in fostering the development of new and emerging technologies. The state has done this through numerous programs such as the development of the Life Sciences Corridor and the Technology Tri-corridor and the creation local “smart zones”. Research indicates that small businesses are largely responsible for much of the job growth in recent years. Moreover, it is generally believed that the development of small, high tech firms could be a major way to stem the flow of job loss in the state and lead the way to an economic recovery. It has been suggested that in order to spur the development of these small, high tech firms, certain tax incentives should be offered.

THE CONTENT OF THE BILL:

Together, the bills would provide a qualified start-up business with a credit against or exemption from various taxes. The two main bills are House Bill 5331 and Senate Bill 863, which provide a credit against the single business tax and income tax, respectively. A business would have to claim a credit against either of those two taxes as a condition of receiving a credit or exemption against general property taxes, the city income tax, and several specific taxes levied in lieu of the property tax. With the exception the single business tax credit and income tax credit, all of the credits and exemptions would be subject to the approval by the governing body of the local tax collecting unit, which would also have to provide a hearing regarding the credit or exemption to the local assessor and representatives of the affected taxing units. All of the bills are tie-barred to House Bill 5331.

A “qualified start-up business” would be defined to mean a business that (1) has fewer than 25 full-time equivalent employees; (2) has sales of less than \$1 million in the tax year in which the credit is claimed; (3) has research and development expenses – as defined under the federal Internal Revenue Code – of at least 15 percent of its total expenses in the tax year in which the credit is claimed; (4) is not publicly traded; and (5) was in or would have been in the first two years of contribution liability under the Michigan Employment Security Act, in the immediately preceding seven years. The term is defined in House Bill 5331, but is used in all of the bills.

House Bill 5331 (Single Business Tax)

The bill would amend the Single Business Tax (MCL 208.31) to provide a “qualified start-up business” a credit against the SBT equal to its tax liability if the business does not have business income for two consecutive years. The credit could be claimed in the second of those years. The credit would be available for tax years beginning after December 31, 2004, and could not be claimed for more than five tax years. [In all actuality, the credit could be claimed for a maximum of four tax years, as the single business tax is slated for elimination at the end of 2009. The credit could first be claimed in 2006, and could be claimed each tax year thereafter.]

If the taxpayer has no business activity in the state but has business activity outside of the state in any of the first three years following the last tax year in which it claimed the credit, the taxpayer would be liable for all or a portion of the total amount of credits claimed, as follows: (1) the taxpayer would be liable for 100 percent of the credits if it has no business activity in the state in the tax year immediately following the last tax year in which it claimed the credit; (2) the taxpayer would be liable for 67 percent of the credits if it has no business activity in the second year after the last tax year in which it claimed the credit; and (3) the taxpayer would be liable for 33 percent of the credits if it has no business activity in the state in the third tax year after the last tax year in which it claimed the credit. In addition, for the tax year in which the credit is claimed, any compensation, director's fees, or distributive shared paid to a shareholder or officer of a corporation other than an S corporation, a partner of a partnership or limited liability partnership, a shareholder of an S corporation, or an individual owner could not exceed \$135,000.

A member of an affiliated group, a controlled group of corporations, or an entity under common control would determine the number of employees, sales, and business income for purposes of claiming the credit on a consolidated basis.

Senate Bill 863 (Income Tax Act)

The bill would amend the Income Tax Act (MCL 206.51f) to provide a taxpayer that is a qualified start-up business that does not have income attributable that business for two consecutive years. The credit could be claimed in the second of those years. The credit would be available for tax years beginning after December 31, 2004, and could not be claimed for more than five tax years.

If the taxpayer has no business activity in the state but has business activity outside of the state in any of the first three years following the last tax year in which it claimed the credit, the taxpayer would be liable for all or a portion of the total amount of credits claimed, as follows: (1) the taxpayer would be liable for 100 percent of the credits if it has no business activity in the state in the tax year immediately following the last tax year in which it claimed the credit; (2) the taxpayer would be liable for 67 percent of the credits if it has no business activity in the second year after the last tax year in which it claimed the credit; and (3) the taxpayer would be liable for 33 percent of the credits if it has no business activity in the state in the third tax year after the last tax year in which it claimed the credit.

House Bill 5335 (Neighborhood Enterprise Zone Act)

The bill would amend the Neighborhood Enterprise Zone Act (MCL 207.779) to provide a new or rehabilitated facility owned or operated by a qualified start-up business with an exemption from the neighborhood enterprise zone tax, except special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The exemption would be for five consecutive year beginning on December 31 in the year in which the business first claimed the start-up single business tax or income tax credit. The

business would have to file an exemption affidavit with the assessor of the local tax collecting unit within 60 days of becoming exempt. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units.

The Neighborhood Enterprise Zone Act levies a specific tax in lieu of a general property tax against new or rehabilitated facilities located within a neighborhood enterprise zone. The tax has two different calculations. For new facilities (not including land) that are not principal residences, the tax is determined by calculating the product of the taxable value of the facility (excluding land) and one-half of the average rate of taxation levied upon commercial, industrial, and utility property in the state for the previous year. For rehabilitated facilities, the tax is determined by calculating the product of the taxable value of the facility (excluding land) for the previous year (that is, prior to rehabilitation) and the total mills collected under the General Property Tax Act for the current year by all taxing units within which the facility is located.

House Bill 5341 (General Property Tax Act)

The bill would amend the General Property Tax Act (MCL 211.7hh) to exempt all real and personal property of a qualified start-up business from taxation under the act. The exemption would be effective for five consecutive tax years beginning on the December 31 of the tax year in which the business claimed the start-up single business tax or income tax credit, or the year in which the resolution was adopted, whichever is later. A business could claim the exemption by filing an affidavit with the assessor of the local tax collecting unit.

Real and personal property of a qualified start-up business would not be exempt from a special assessment, ad valorem property taxes specifically levied for the payment of principal and interest of bonds, and certain taxes levied under the Revised School Code.

House Bill 5342 (Enterprise Zone Act)

The bill would amend the Enterprise Zone Act (MCL 125.2121c) to facility owned or operated by a qualified start-up business with an exemption from the neighborhood enterprise zone tax, except special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The business would have to file an exemption affidavit with the assessor of the local tax collecting unit within 60 days of becoming exempt. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units. The exemption would be for five consecutive year beginning on December 31 in the year in which the business first claimed the start-up single business tax or income tax credit.

The Enterprise Zone Act allows for the creation of special zone to spur investment and job creation in certain distressed areas throughout the state. In lieu of the property tax levied under the General Property Tax Act, a specific tax is levied on property within an enterprise zone. The tax has two basic calculations, depending on when the enterprise zone was created. For property located within an enterprise zone created before 1994

(only the City of Benton Harbor), the tax is, generally speaking, either (depending on the circumstances) (1) the product of one-half of the statewide average property tax rate on commercial, industrial, and utility property and the state equalized value of the property (excluding certain exemptions), or (2) the total property tax rate by all taxing units within which the property is located and the state equalized value (excluding certain exemptions). For property located within an enterprise zone created after 1993, the tax is the sum of the following:

- the product of (1) one-half of the statewide average property tax rate on commercial, industrial, and utility property, and (2) the increase in state equalized value (excluding certain exemptions).
- the product of (1) the total millage levied under the State Education Tax Act, and (2) the increased state equalized value (excluding certain exemptions)
- the product of (1) total millage levied as real and personal property taxes by all taxing units, and (2) the initial state equalized value of that property (excluding certain exemption).

House Bill 5343 (Obsolete Property Rehabilitation Act)

The bill would amend the Obsolete Property Rehabilitation Act (MCL 125.2790) to provide a rehabilitated facility owned by a qualified start-up business with a exemption from the obsolete properties tax, except for that portion of the tax attributable to special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units. The tax exemption would be available for a period of five years starting on December 31 in the year in which the business first claimed the start-up single business tax or income tax credit.

Under the act, a qualified local unit of government may establish an obsolete property rehabilitation district to provide tax abatements to commercial facilities and residential property undergoing rehabilitation. In lieu of the property tax levied under the General Property Tax Act, the act levies the obsolete properties tax, which is the sum of the following:

- the product of (1) the total mills levied by all taxing units within which the obsolete property is located, for the year prior to the year in which the obsolete property rehabilitation exemption certificate was certified (that is, prior to rehabilitation), and (2) the taxable value of the obsolete property (excluding the taxable value of the land and personal property other certain personal property assessed under the General Property Tax Act).
- the product of (1) the state and local school operating mills, and (2) the taxable value of the real and personal property of the rehabilitated facility, after making certain deductions.

House Bill 5345 (City Income Tax Act)

The bill would amend the City Income Tax Act (MCL 141.635a) to provide a taxpayer with a credit against the tax equal to the tax liability attributable a qualified start-up business. The tax credit would be available for a period of five years starting on December 31 in the year in which the business first claimed the start-up single business tax or income tax credit (though, in all actuality, the taxpayer would not claim the single business credit). The credit would be effective for a city that adopts a resolution allowing for the credit within 90 days after the bill's effective date.

Generally speaking, the City Income Tax Act permits cities to levy an income tax of one percent against business income that is attributable to a firm's operations in that city. The rates in Detroit, Grand Rapids, Highland Park, and Saginaw are greater than one percent.

Senate Bill 865 (Lessee-User Tax)

Public Act 189 of 1953 provides that, with certain exceptions, if real property exempt from ad valorem property taxation is leased, loaned, or otherwise made available to and used in connection with a for-profit business, the lessee or user of the property is subject to taxation (so-called lessee-user taxes) in the same amount and to the same extent as if the lessee or use owned the real property.

The bill would exempt, for taxes levied after December 31, 2004, real and personal property of a "qualified start-up business" from the lessee-user tax for a period of five years beginning on the December 31 of the year in which the business first claimed the start-up single business tax credit or income tax credit. Property would not be exempted from (1) the collection of a special assessment levied by a tax collecting unit in which the property is located; (2) ad valorem property taxes specifically levied for the payment of principal and interest of bonds; and (3) a regional enhancement property tax levied by an intermediate school district or a sinking fund property tax levied by a school district under the Revised School Code.

Senate Bill 867 (NREPA)

The bill would amend Part 511 (Commercial Forests) of the Natural Resources and Environmental Protection Act to exempt commercial forestland owned or operated by a qualified start-up business, except that portion of the tax attributable to special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The exemption would be available for a period of five years beginning on December 31 in the year in which the business claimed the start-up single business tax or income tax credit. The business would have to file an exemption affidavit with the assessor of the local tax collecting unit within 60 days of becoming exempt from the tax. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units.

Part 511 of the Natural Resources and Environmental Protection Act provides that commercial forests are not subject to property taxes, but, with certain exceptions, are subject to a specific tax levied at \$1.10 per acre.

Senate Bill 869 (Plant Rehabilitation and Industrial Development Act)

The bill would amend the Plant Rehabilitation and Industrial Development Act (MCL 207.561) to exempt a speculative building, new facility, or replacement facility of a qualified start-up business from the industrial facility tax, except for that portion of the tax attributable to special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units. The tax exemption would be available for a period of five years starting on December 31 in the year in which the business first claimed the start-up SBT credit or income tax credit. The business would have to file an exemption affidavit with the assessor of the local tax collecting unit within 60 days of becoming exempt from the tax. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units.

Under the act, commonly known as P.A. 198, local governmental units may provide new, renovated, or expanded industrial facilities with property tax abatement for up to 12 years. In lieu of the property tax, businesses pay the industrial facility tax. Under the act, renovated facilities are taxed at the same local property tax rate, though the taxes are based on the taxable value of the facility (excluding land and inventory) during that immediately preceding tax year (meaning, prior to the renovation). For new facilities, the tax rate is the sum of half of all other taxes other than the State Education Tax and the State Education tax, based on the current taxable value of the new facility.

Senate Bill 872 (Technology Park Development Act)

The bill would amend the Technology Park Development Act (MCL 207.712) to exempt a facility owned or operated by a “qualified start-up business” from the technology park facilities tax, except for that portion of the tax attributable to special assessments, debt millages, school enhancement millages, and school building sinking fund millages. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units. The tax exemption would be available for a period of five years starting on December 31 in the year in which the business first claimed the start-up SBT credit or income tax credit. The business would have to file an exemption affidavit with the assessor of the local tax collecting unit within 60 days of becoming exempt from the tax. The portion of the tax that is collected would be distributed proportionately to the appropriate taxing units.

The Technology Park Facilities Tax is a specific tax levied in lieu of the general property tax against facilities located in a technology park district, on the state equalized value of a facility (excluding land and inventory) at a rate of the sum of (1) one-half of the 1993 school operating millage and (2) one-half of all property tax mills, except the state and local school operating mills.

Senate Bill 875 (City Utility Users Tax)

The bill would amend the City Utility Users Tax Act to exempt a qualified start-up business from the city utility users' tax for a period of five consecutive years beginning with the first year in which the business claimed the start-up single business tax credit or income tax credit. The business would have to file an exemption with the assessor of the local tax collecting unit within 60 days after becoming exempt from the tax. The credit would be effective for a city that adopts a resolution allowing for the credit within 90 days after the bill's effective date.

The City Utility Users Tax Act permits the City of Detroit to levy, assess, and collect from those users in that city a utility users tax, in increments of 1/4 of 1% that shall not exceed 5%. The tax is levied on intrastate telephone communication services, electrical energy, steam, and natural and artificial gas provided by a public utility or a resale customer. Revenue from the tax is used to retain or hire police officers.

ARGUMENTS:

For:

It is generally believed that the development and growth of small, high-tech firms is a key to the state's economic well-being. During the most recent economic downturn, the state has lost thousands of well-paying manufacturing jobs. These losses are likely to be permanent. Where the state has seen increased employment is in the service sector. However, these jobs typically do not pay as well as the manufacturing jobs that they replaced. To that end, the state must look to new industries, such as, biotechnology, nanotechnology and, of course, automotive technology. Indeed, a recent report by the Michigan Economic Development Corporation states, "[e]ven with the recent softening of the global-economy, companies continue to have difficulty filling these high-paying technology jobs in our state. If Michigan is to sustain a positive economic future, economic development strategies and policies must be refined and directed toward investments that retain, create, and attract more and more of these businesses, jobs, and workers." A February 2004 article in the *Detroit Free Press* appropriately entitled, "Michigan's Employment Crisis: Biotech firms could be cure for job losses", presents this issue quite well. The article notes that, "[t]he evolution of the state's biotech industry - still considered by many analysts to be in its infancy - could redefine the state's labor environment." However, it asks whether state business and political leaders have the commitment necessary to support biotech growth. This package of bills demonstrates that commitment. In addition, the article later states, "[s]mall biotech companies are usually private, produce few profits and are usually started by groups of scientists specializing in certain areas of research. However, the research they conduct could lead to significant scientific breakthroughs, mountains of money and national prestige." This package of bills provides these businesses with some tax relief in an effort to help get them off the ground.

In addition, an April 2004 article in the *Detroit Free Press* recently characterized the transformation of the state's economy from one based on the manufacturing industry to

one based on the development of technology as being “Michigan’s evolution from brawn to brains.” This transformation will help Michigan remain the automotive leader in the country. Years ago the state was the automotive leader with corporate headquarters and numerous manufacturing plants. While the manufacturing plants are closing, the state can retain its status as the leader in the automotive industry by becoming the center for automotive technology and research.

Against:

The package of bills confounds many other economic development efforts of the state, particularly through the creation of renaissance zones and smart zones. This package provides tax relief similar to that offered by renaissance zones, by exempting taxpayers from various property taxes. However, the creation of renaissance zones is designed to spur economic development in distressed areas very much in need of rehabilitation and new development. By providing similar tax benefits, the package actually discourages redevelopment of the state’s core urban areas.

In addition, the package will take away funds for the development of smart zones. Smart zones (certified technology parks) are collaborations between universities, industry, research organizations, government, and other community institutions that are intended to stimulate growth of technology-based businesses and jobs. They are designed to attract and develop the start-up businesses targeted by the package, and provide distinct geographical locations where technology-based firms, entrepreneurs, and researchers can locate in close proximity to one another so as to best utilize the assets of the community. There are currently 11 smart zones throughout the state. For example, the Automation Alley Smart Zone is a collaboration of Automation Alley, the City of Southfield, City of Troy, City of Rochester Hills, Lawrence Technological University, Oakland University, and Oakland County. The proposal calls for the establishment of a Technology Center within the City of Troy. While the Technology Center will be physically located in Troy, it will be linked to all of the Automation Alley Smart Zone and provide a wide range of services and programs to support the commercialization of products and technologies. Smart zones are funded through tax increment financing whereby the amount of property taxes collected beyond the base year in which the zone was created are captured and used for the benefit (public improvements) of the smart zone. The problem is that providing tax breaks to start-ups located in smart zones takes away most of the funding source for the smart zones.

Against:

The bills, like other types of tax exemptions and credits, create some equity problems, particularly for the several property taxes, as it provides tax breaks to some businesses and not to others. Moreover, the state shouldn’t be in the business of picking winners and losers by providing tax breaks to some businesses and not others. Currently, many small businesses other than technology start-ups throughout the state could benefit from tax breaks offered through this package.

POSITIONS:

The Small Business Association of Michigan supports the bills. (4-28-04)

The National Federation of Independent Businesses - Michigan supports the bills. (4-28-04)

The Michigan Municipal League supports the bills. (4-27-04)

The Michigan Assessors Association opposes House Bills 5335, 5341, 5342, and 5343, and Senate Bills 865, 867, and 872. (4-27-04)

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Fiscal Analyst: Rebecca Ross

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.