Legislative Analysis

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START-UP BUSINESS INCENTIVES

House Bill 6025 (Substitute H-2)
Sponsor: Rep. Matt Milosch

House Bill 6026 (Substitute H-1)
Sponsor: Rep. Scott Hummel

Committee: Tax Policy
First Analysis (6-24-04)

BRIEF SUMMARY: The bills would provide certain start-up businesses with exemptions from taxation under the General Property Tax Act and the Obsolete Property Rehabilitation Act

FISCAL IMPACT: The fiscal impact of HB 6025 and HB 6026 would depend on the number of qualified start-up businesses and the degree to which local units approve exemptions.

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 of 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. Earlier this session, as part of a larger package of bills aimed at fostering the development of start-up, high-tech businesses, the legislature passed bills that would have exempted such businesses from taxation under the General Property Tax Act and the Obsolete Property Rehabilitation Act. Those bills, along with all but one bill in the package, were vetoed by the governor in May. Legislation that attempts to address several of the governor's criticisms regarding two of the bills has been introduced.

THE CONTENT OF THE BILL:

House Bill 6025 (General Property Tax Act)

The bill would amend the General Property Tax Act (MCL 211.7hh) to exempt the real and personal property of a "qualified start up business" from taxation under the act. In order to claim the exemption, the business would have to apply for the exemption, and the governing body of the local tax collecting unit or, in certain instances, the county board of commissioners, would have to adopt a resolution approving the exemption. A qualified start-up business could not claim the exemption for more than five tax years. In addition, the exemption would not apply to special assessments, ad valorem property taxes levied specifically to the payment of principal and interest on bonds, and certain taxes levied under the Revised School Code.

If an exemption is erroneously granted, the tax roll would be corrected for the current tax year and the three previous tax years. If the property owner pays the corrected tax bill within 60 days after the corrected bill is issued, the owner would not be liable to any penalty or interest on the additional tax.

Application for the exemption - In order to claim the exemption, the business would have to file an affidavit on or prior to May 1 in each tax year with the assessor of the local tax collecting unit. The affidavit would have to state that the business qualified and received the Single Business Tax start-up credit (added by Public Act 126 of 2004/House Bill 5331). In addition, the affidavit would also have to include the business's SBT return for the tax year in which the business claimed the SBT start-up credit, and a statement that authorizes the Department of Treasury to release information in that return relevant to the SBT start-up credit.

If the business files for an extension to file its SBT return, the business could still claim the property tax credit after May 1 if the governing body of the local tax collecting unit or the county board of commissioners approves the exemption for all qualified start-up businesses that file for an extension, and if the business submits a copy of its application for an extension and the affidavit to the December Board of Review. The bill specifies that an exemption granted to a business that filed an extension would be considered to be the correction of a clerical error.

Local government approval - In order to actually provide an exemption, the governing board of the local tax collecting unit would have to adopt a resolution approving the exemption. The clerk of the tax collecting unit would have to notify the tax collecting unit's assessor and the legislative body of each taxing unit that levies ad valorem property taxes within that tax collecting unit. The assessor and representatives of the affected taxing unit would be provided a hearing regarding the approval of the exemption. If a resolution is adopted, the exemption would not apply to those affected taxing units that pass a resolution within 45 days that denies the exemption for taxes levied by that taxing unit. If the local tax collecting unit does not adopt a resolution approving the exemption, the county board of commissioners could adopt a resolution providing an exemption from taxes levied by the county. The resolution could provide the exemption to one or more businesses that apply for the exemption prior to May 1 or to all start-up businesses that apply for the exemption after May 1.

House Bill 6026 (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. In order to provide the exemption, the local tax collecting unit would have to adopt a resolution in the same manner and under the same terms and conditions as provided (that is, the same process) in House Bill 6025.

The tax exemption would be available only for the year in which the resolution is adopted, though a qualified start-up business would not be eligible for the exemption for more than five years.

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.

BACKGROUND INFORMATION:

A ***"****qualified start-up business****"*** is defined in the Single Business Tax Act 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 for which the credit is claimed; (3) has research and development expenses (as defined under the federal Internal Revenue Code) that constitute at least 15 percent of its expenses in the tax year for 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. This term was added to the Single Business Tax Act by Public Act 126 of 2004 (House Bill 5331). That act creates an SBT credit for this category of businesses.

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.

For:

These bills are attempts to diffuse the criticisms of the governor regarding House Bill 5341 and 5343. Those two bills would have exempted property from taxation under those acts for a period of five years beginning in the year in which the start-up business qualified for the SBT start-up businesses credit. Under the Single Business Tax Act (as amended by Public Act 126 of 2004), a qualified start-up business can claim a credit against the SBT equal to its tax liability in the second year of a two-year period in which the business did not have business income. To this point, Governor Granholm noted in her veto message that, “the five-year tax exemption under [House Bills 5341 and 5343] would not begin until two years after a business initially qualifies for a single business tax reduction under House Bill 5331. As a result, the exemptions under these bills are disconnected for up to seven years from the condition rendering the business eligible for the exemption. To assure needed job creation in Michigan, tax incentives must be more focused and accurately targeted.”

In response these bills provide for a more targeted approach by, subject to local approval, providing qualified start-up businesses with tax relief when they truly need tax relief. The bill requires that the affidavit included in the application for the exemption state that the business qualified for the SBT start-up credit (meaning that the business has no business income). Moreover, the bill requires the businesses to annually apply for the exemption, rather than providing an exemption for a full five year period, regardless of financial need.

POSITIONS:

The Michigan Municipal League supports the bill. (6-23-04)

The Michigan Association of Counties supports the bills. (6-23-04)

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