

Telephone: (517) 373-5383 Fax: (517) 373-1986 TDD: (517) 373-0543

Senate Bill 862 (Substitute S-1 as reported)

Senate Bills 863 through 868 (as reported without amendment)

Senate Bills 870, 871, 872, and 875 (as reported without amendment)

Sponsor: Senator Laura Toy (S.B. 862)

Senator Bill Hardiman (S.B. 863) Senator Tom George (S.B. 864) Senator Virg Bernero (S.B. 865)

Senator Cameron S. Brown (S.B. 866) Senator Gerald Van Woerkom (S.B. 867)

Senator Alan Sanborn (S.B. 868) Senator Alan L. Cropsey (S.B. 870) Senator Ron Jelinek (S.B. 871) Senator Bruce Patterson (S.B. 872) Senator Jud Gilbert, II (S.B. 873)

Committee: Economic Development, Small Business and Regulatory Reform

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RATIONALE

Michigan has experienced a substantial job loss over the last few years. Small business, which has traditionally been a vital part of the State's economy, is often identified as a potential area for job creation and economic recovery. In particular, small, high-technology firms have received much attention recently. It has been suggested that these small research and development firms should be offered tax incentives similar to those offered to businesses that locate in renaissance zones, in order to spur job creation and economic growth.

CONTENT

Senate Bill 862 (S-1) would amend the Single Business Tax Act to create a single business tax (SBT) credit for a taxpayer that was a qualified start-up business that did not have net income for two consecutive tax years, for tax years beginning after December 31, 2003. Senate Bills 863 through 868, 870, 871, 872, and 875 would amend various acts to allow a qualified start-up business to claim a credit against or an exemption from various taxes for five consecutive years, beginning on December 31 of the year in which the business first claimed the credit proposed by Senate Bill 862 (S-1).

Under Senate Bill 862 (S-1), "qualified start-up business" would mean a business that had fewer than 25 full-time equivalent employees; had sales of less than \$1,000,000 in the tax year for which the credit was claimed; and was not publicly traded; also, research and development would have to make up at least 15% of its expenses in the tax year for which the credit was claimed.

The bills are described below in further detail.

Senate Bill 862 (S-1)

Under the bill, for tax years beginning after December 31, 2003, a qualified start-up business that did not have net income for two consecutive tax years could claim an SBT credit for the second of those tax years and each immediately following consecutive tax year in which the taxpayer did not have net income. If the taxpayer had net income in any of the intervening tax years, the two consecutive years without net income threshold would have to occur after the tax year in which the taxpayer had net income, before the taxpayer could claim the credit for any following tax year. The credit would equal the taxpayer's SBT liability for the tax year in which the taxpayer had no net income. A credit could not be claimed for more than four tax years in total.

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A member of an affiliated group as defined in the Act, a controlled group of corporations as defined in Section 1563 of the Internal Revenue Code, or an entity under common control as defined by the Code would have to determine net income for purposes of claiming the credit on a consolidated basis. (Under the Act, "affiliated group" means two or more United States corporations, one of which owns or controls, directly or indirectly, at least 80% of the capital stock with voting rights of the other corporation or corporations.)

Senate Bill 863

The bill would amend the Income Tax Act to allow a qualified start-up business to claim a credit against the income tax equal to its tax liability under the Act.

Senate Bill 864

The bill would amend the General Property Tax Act to exempt real and personal property of a qualified start-up business from the collection of taxes under the Act.

Senate Bill 865

The bill would amend Public Act 189 of 1983 to exempt real and personal property of a qualified start-up business from the tax levied under the Act. Under the Act, if real property exempt for any reason from ad valorem property taxation is leased, loaned, or otherwise made available to and used in connection with a business conducted for profit, the lessee or user is subject to taxation in the same amount and to the same extent as though the lessee or user owned the real property.

Senate Bill 866

The bill would amend the City Income Tax Act to allow a qualified start-up business to claim a credit against the city income tax. If the city income tax credit and any unused carryforward exceeded the taxpayer's tax liability for the tax year, the excess could not be refunded but could be carried forward as an offset to the tax liability in subsequent tax years, for 10 tax years or until the excess credit was used up, whichever occurred first.

Senate Bill 867

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 from the annual specific tax levied on commercial forests under Part 511.

Senate Bill 868

The bill would amend the Enterprise Zone Act to exempt a facility owned or operated by a qualified start-up business from the specific tax imposed on facilities in enterprise zones.

Senate Bill 870

The bill would amend the Obsolete Property Rehabilitation Act to exempt a rehabilitated facility owned and operated by a qualified start-up business from the obsolete properties tax, which is levied upon the owner of a rehabilitated facility to which an obsolete property exemption certificate is issued.

Senate Bill 871

The bill would amend the Neighborhood Enterprise Zone Act to exempt a new or rehabilitated facility owned or operated by a qualified start-up business from the neighborhood enterprise zone tax, which is imposed on the owner of a new or rehabilitated facility to which a neighborhood enterprise zone certificate is issued.

Senate Bill 872

The bill would amend the Technology Park Development Act to exempt a qualified start-up business from the technology park facilities tax, which is levied upon every owner and every user or occupant, if known, of a facility to which a certificate is issued under the Act.

Senate Bill 875

The bill would amend the City Utility Users Tax Act to exempt a qualified start-up business from the tax imposed in the City of Detroit on intrastate telephone communication services, electrical energy, steam, and natural and artificial gas provided by a public utility or a resale customer.

Proposed MCL 208.31a (S.B. 862) Proposed MCL 206.51f (S.B. 863) Proposed MCL 211.7gg (S.B. 864) Proposed MCL 211.181a (S.B. 865) Proposed MCL 141.635a (S.B. 866) MCL 324.51105 (S.B. 867)

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125.2121c (S.B. 868) 125.2790 (S.B. 870) 207.779 (S.B. 871) 207.712 (S.B. 872) 141.1155 (S.B. 875)

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

To address the substantial job loss that has occurred in Michigan over the last several years, the State must consider new industries and new ways to create jobs. Small, fast-growing, high-tech firms present promising opportunities for economic recovery. It is critical that the State offer a business environment that attracts new companies and retains those already here. By offering tax incentives similar to those available to facilities located in renaissance zones, the bills would help keep Michigan competitive with surrounding states.

Many of Michigan's leading companies began with an entrepreneur purchasing the rights to university research using Federal grant money. In fact, 75% of United States patents are based on public research. In the 1990s, Michigan was seventh in the nation for businesses securing Federal grants in order to purchase the rights to university research for commercialization. Over the last few years, however, the State has failed to turn much of technological development at its universities into a marketable commodity, and now ranks 18th. The tax incentives offered in the bills would enable fast-growing, private firms to capture the significant research and development done in public institutions and turn it into profitable enterprises, which in turn would benefit the State economically and promote Michigan as a place to do business.

Opposing Argument

In order to qualify for the SBT credit, which would trigger various other credits and exemptions, a business would have to show no net profit for two years. It does not seem prudent to offer an unsuccessful business tax breaks.

Response: Many successful companies get off to a slow start in terms of making a profit. Often, there is no pay-off for four to six years after a business is initiated. These tax

incentives would help turn promising opportunities into viable businesses. Even if only a handful of the eligible firms were successful, they could add several hundred jobs to Michigan's economy.

Opposing Argument

The bills could contribute to the erosion of the local tax base and negatively affect the quality of life for residents. Under the bills, a firm that already might have existed for many years could qualify as a start-up business. Once the four- or five-year limit on the credits and exemptions was up, there is no guarantee that a business would stay in the municipality, or even the State. Businesses could take advantage of the incentives to get started, and then leave without contributing the economic development that was promised. Communities could even screen prospective new businesses based on which ones would be exempt from the property tax.

Response: If a company were first established in Michigan, and the business environment remained favorable, the company would be likely to stay in Michigan.

Opposing Argument

There are several issues of concern within Senate Bill 862 (S-1). First, the limit for affiliated entities should be tightened. The bill's current language does not sufficiently target small, independent businesses. A spinoff of a publicly traded company with at least 15% of its expenses invested in research and development still could receive the tax breaks.

Second, the term "net income" is not defined anywhere in the Single Business Tax Act. That term is used for corporate accounting purposes, and is not appropriate for the small companies, such as limited liability partnerships, that the bills aim to help.

Opposing Argument

For the purposes of the property tax exemptions, local units of government would have to rely on individual businesses to report that they were exempt. Rather than putting local governments in charge of trying to identify exempt firms, the legislation should offer businesses a refundable credit for the value of the property, similar to the homestead property tax credit.

Legislative Analyst: Julie Koval

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FISCAL IMPACT

Senate Bill 862 (S-1)

There are approximately 200,000 business firms in Michigan and about 1,400 of these businesses are conducting some type of research and development (R&D) activity. This bill would provide a tax credit equal to a business's total single business tax liability, and any new or existing business would qualify for this credit if it met the following five requirements:

- 1. Had no net income for two consecutive years.
- 2. Had fewer than 25 employees (calculated on a full-time equated basis),
- 3. Had annual sales of less than \$1 million,
- 4. Conducted R&D activity that accounted for at least 15% of its total business expenses,
- 5. Was not a publicly traded business, and
- 6. Had a single business tax liability.

It is estimated that less than 5%, or about 65 firms, of the 1,400 firms that currently conduct some type of R&D activity would meet all of these requirements, and therefore would be eligible for this proposed tax credit. It is estimated that collectively these businesses would realize an SBT reduction totaling \$0.4 million in FY 2003-04 and \$0.6 million in FY 2004-05. This estimated loss in single business tax revenue would have an impact on General Fund/General Purpose revenue. The bill would have no direct impact on local government.

Businesses would be able to claim the tax exemptions proposed by Senate Bills 863 through 868, 870, 871, 872, and 875 only if they claimed the SBT credit proposed by Senate Bill 862 (S-1), although the bills are not tie-barred. The fiscal impact of those bills, described below, would be contingent on the enactment of Senate Bill 862 (S-1).

Senate Bill 863

It is estimated that the bill would reduce income tax revenue by about \$1 million; however, the loss in income tax revenue could be much larger. Under this bill, the owner of a company conducting R&D and able to claim an SBT credit under Senate Bill 862 (S-1), would receive an income tax exemption on both the income received from the R&D business and any income received from any other source. As a result, a very wealthy

individual with a very large income would be able to receive a total exemption from the State income tax even if the income received from the R&D business were a very small portion of the owner's total income. A \$1 million loss in income tax revenue would reduce General Fund/General Purpose revenue by \$741,000 and School Aid Fund revenue by \$259,000. This would not affect local government.

Senate Bill 864

The property tax exemption proposed by this bill would provide eligible businesses with property tax reductions totaling \$0.5 million, assuming these businesses all own their own building. If these businesses lease the building in which they perform their work, then they would be paying property taxes only on their personal property. Under this scenario, it is estimated that the property tax reduction under this bill would be less than \$50,000.

The estimated loss in property tax revenue of \$0.5 million would have the following impact: State education property tax revenue, which is earmarked to the School Aid Fund, would be reduced \$60,000, local school property tax (18 mills) would be reduced \$177,000, and the remaining local property taxes would be reduced \$264,000.

Senate Bill 865

It is estimated that the bill would result in a very minimal, if any, loss in property tax revenue.

Senate Bill 866

The bill would reduce local unit revenue by an unknown amount. Under the bill, a taxpayer that was able to claim the SBT credit proposed by Senate Bill 862 (S-1), also could claim a credit against its city income tax equal to the business's total tax liability to the city, not just the tax liability related to the activity that earned the SBT credit. Consequently, while the activity that could earn the SBT credit is forecasted to be negligible, Senate Bill 866 could exempt a much wider array of economic activity from taxation and thus create a greater reduction in local unit revenues.

Further, because the bill would reduce city income tax liability, the State would see less claimed under the city income tax credit and

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income tax revenues would be higher if Senate Bill 863 were not enacted.

Senate Bill 866 provides for the credit to be carried forward if it exceeded the liability of the taxpayer. Under the wording for the credit, however, no carry-forward would ever exist because the credit would always be equal to the amount of the liability.

Senate Bill 867

This bill would reduce local and State School Aid Fund revenues by approximately zero. Commercial forest tax revenues are expected to total approximately \$2.7 million in FY 2003-04. No estimates are available on the portion of commercial forests owned or operated by nonpublicly traded businesses with fewer than 25 employees and sales of less than \$1 million, that failed to make a profit but had liability under the SBT Act. However, data indicate that in 2000 no research and development money was spent in Michigan by firms in the forestry sector--suggesting the bill would have no impact on revenues.

Senate Bills 868 and 870-872

These bills would reduce State and local revenue and increase School Aid Fund expenditures by an unknown and likely negligible amount. Based on current estimates, the total of all property taxes on the property of eligible businesses is approximately \$500,000, without accounting for areas such as renaissance zones, enterprise zones, brownfield zones, etc. or special provisions such as those regarding obsolete property that has been rehabilitated. What share of this property is located in an enterprise or other zone is unknown, but if 10% of this property were located in areas affected by these bills or were property affected by these bills, the bills would reduce State and local revenue by less than \$50,000. Because School Aid Fund payments to school districts increase as locally raised revenue declines, a decline in locally raised revenue under the bill would increase payments, by less than \$50,000, from the School Aid Fund.

> Fiscal Analyst: Jay Wortley David Zin

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