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BILL ANALYSIS

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Senate Bill 525 (as enrolled)
Sponsor: Senator Michael D. Bishop
Senate Committee: Commerce and Labor
House Committee: Commerce

PUBLIC ACT 102 of 2005

Date Completed: 4-11-06

RATIONALE

The Michigan Early Stage Venture Investment Act was enacted in 2003 to provide for the creation of the nonprofit Michigan Early Stage Venture Investment Corporation and require it to create the Michigan Early Stage Venture Investment Fund; establish an investment plan; and solicit contributions to, and make money available from, the Fund for investment in venture capital companies in Michigan. To secure investment in the Fund, the Corporation must enter into agreements with investors that contain an established and agreed-upon investment amount and repayment schedule, a guaranteed negotiated amount or negotiated return on investment over the term of the agreement, and a maximum amount of tax credits that the investor may claim in the event that repayment from the Fund falls short of the amount specified in the agreement.

The Act required the Corporation to be incorporated as a nonprofit corporation that, by September 1, 2004, received a favorable determination from the Internal Revenue Service (IRS) that the Corporation is a nonprofit corporation exempt from taxation under the Internal Revenue Code. The Corporation received its tax-exempt determination, but it was not delivered by the date specified in the Act. It was suggested that the tax-exemption determination date be changed.

In addition, Act allowed the Corporation to employ a fund manager and other people considered necessary to implement the Act, and specified that the Corporation could employ only one fund manager at any one time. Some people believed that the Corporation should be allowed to hire multiple fund managers.

Also, it was suggested that the Act should provide for an investor to use a tax voucher to pay his or her tax liability, rather than claim a tax credit against his or her tax liability.

CONTENT

The bill amended the Michigan Early Stage Venture Investment Act to do all of the following:

- **Change the date by which the Corporation had to be incorporated and receive tax-exempt status.**
- **Allow the employment of multiple fund managers.**
- **Provide for investors to receive tax vouchers rather than tax credits.**

The bill took effect on July 22, 2005.

Incorporation/Tax-Exempt Status

The bill changed the date by which a Michigan Early Stage Venture Investment Corporation had to be incorporated as a nonprofit corporation that received a favorable determination from the IRS that it is exempt from taxation under Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code. The Act previously required incorporation and IRS nonprofit determination by September 1, 2004. The bill changed the deadline to August 1, 2005.

Fund Managers

The bill allows the Michigan Early Stage Venture Investment Corporation to employ "fund managers", rather than "a fund manager", and deleted a requirement that the Corporation employ only one fund manager at any one time.

Tax Vouchers

The Act originally required each agreement between the Corporation and its investors to contain a maximum amount of credit that the investor could claim under the Single Business Tax (SBT) Act or the Income Tax Act (pursuant to Public Acts 295 and 297 of 2003). The bill refers to the amount of tax "vouchers" that an investor may "use to pay a tax liability" under the SBT Act or Income Tax Act, rather than the amount of "credit" an investor could "claim" under those Acts.

Previously, the Early Stage Venture Investment Act provided that a tax credit issued under it was refundable. The bill specifies instead that the amount of the tax vouchers that may be used may not exceed the tax liability of the taxpayer that uses the voucher. If the tax voucher does exceed the investor's tax liability, however, the excess amount may be retained and used to pay a future tax liability.

The bill also allows a tax voucher to be transferred in whole or in part. A voucher certificate, or the right to be issued and receive a certificate from the Corporation may be transferred if the holder notifies the Department of Treasury and the Corporation of the transfer, the amount of the tax voucher to be transferred, and the transferee's name and tax identification information. The transfer must be on a form prescribed by the Department and the holder of the voucher must send a completed copy of the transfer to the Department within 60 days of the transfer date.

The bill provides that a transfer is irrevocable. If the transfer involves less than all of the voucher, the Department may issue new certificates to the holder and transferee, representing the allocated voucher values after the transfer.

A voucher holder must attach a copy of the tax voucher certificate and, if applicable, a completed transfer form, to its annual return for the tax toward which the holder uses the certificate.

MCL 125.2233 et al.

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

The Michigan Early Stage Venture Investment Act aims to position Michigan for a future of economic growth and diversity by promoting the development of new and progressive businesses in the State. Access to venture capital in Michigan is critical to developing and keeping new companies and jobs, and the 2003 legislation created the Michigan Early Stage Venture Investment Corporation to promote the availability of venture capital that can spur economic growth in Michigan. The Corporation, however, received its IRS tax-exempt designation after the deadline established in the 2003 legislation. By requiring that the Corporation achieve its tax-exempt status by August 1, 2005, rather than September 1, 2004, the bill ensured the Corporation's technical compliance with the statute, thus encouraging the Corporation to fulfill its obligations under the Act and operate as the economic development tool that was envisioned when the Act was adopted.

Supporting Argument

The Act's requirement that the Corporation employ only one fund manager at any one time was unnecessarily restrictive. By employing multiple managers, who have expertise in different types of potential investments, the Corporation may maximize its productivity in investing and managing the Fund.

Supporting Argument

Providing for transferable tax vouchers rather than refundable tax credits may make investment in the Michigan Early Stage Venture Investment Corporation more attractive to investors, thereby making the Corporation a more effective economic development tool.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The fiscal impacts of the major changes made in this bill to the Michigan Early Stage Venture Investment Act are summarized below.

IRS Tax-Exempt Approval Date. The bill changed the date by which the Corporation must have received IRS tax-exempt approval from September 1, 2004, to August 1, 2005. This change is viewed as technical and has no fiscal impact.

Number of Fund Managers. The bill allows more than one fund manager to be hired. The Act gives the Michigan Early Stage Venture Investment Corporation the ability to charge reasonable fees to support its ongoing operations. Therefore, the cost of additional managers, which could run about $100,000 per manager, will have to be covered by these fees. Therefore, this change will have no fiscal impact on the State's General Fund and will not have any direct impact on local government.

Tax Credit Versus Tax Voucher. The bill changes the way by tax reductions offered under this Act will be implemented by replacing the previous tax credits with tax vouchers. This change may help attract investors by improving the overall net tax benefits on these investments. Therefore, it is estimated that granting vouchers instead of tax credits will marginally increase the cost of the income and single business tax reductions that will be granted under this Act. Under a State tax credit, the actual tax owed by a taxpayer decreases, and as a result, some of this tax saving is eroded due to offsetting changes that are triggered in the taxpayer's Federal tax liability. A reduction in a taxpayer's Michigan income or single business tax liability reduces the taxpayer's Federal deduction for State taxes paid and increases the taxpayer's Federal tax liability. This increase in Federal tax liability, therefore, partially offsets the State tax reduction. This unintended erosion in the taxpayer's net tax reduction is avoided under a tax voucher. With a tax voucher, a taxpayer's State tax liability does not change, so there is no change in the taxpayer's Federal income or corporate income tax liability. The only thing that changes by using a voucher is the way in which taxpayers pay their State tax liability. Under a voucher, taxpayers pay all or part of their tax liability by submitting the voucher with their tax return.

Fiscal Analyst: Jay Wortley

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