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BILL ANALYSIS

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Senate Bill 926 (as passed by the Senate)
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 9-20-06

RATIONALE

Under the Michigan Strategic Fund Act, certain nonprofit research and development (R&D) enterprises that receive funding from the Research Center Fund are exempt from the ad valorem property tax. This exemption applies only to enterprises that own and occupy real property in the State and have received at least $1.0 million from the Research Center Fund under the Act or previous legislation. In some cases, R&D facilities operate on leased property, and consequently do not qualify for the property tax exemption. Enterprises also may receive grants from other designated funds, such as the Core Communities Fund. For example, a nonprofit R&D facility located in Ann Arbor received a Core Communities grant for its work on internet technology, but the enterprise is ineligible for a property tax exemption under the Act, because the funds had not been awarded through the Research Center Fund, and because it leases, rather than owns, the R&D facility. Some have suggested that the Act should allow such companies to qualify for the R&D tax exemption.

CONTENT

The bill would amend Section 74 of the Michigan Strategic Fund Act (dealing with the Research Center Fund) to modify the criteria for a property tax exemption for research and development enterprises that received at least $1.0 million in financial aid under Section 74; and to extend the exemption to enterprises that received at least $1.0 million from sources funded under that section or a 1999-2000 appropriation to the Core Communities Fund.

Under Section 74, money held in the Research Center Fund may be used to provide financial aid to certain nonprofit research and development enterprises. Property owned and used or occupied by such an enterprise that receives or has received financial aid of at least $1.0 million under Section 74 (or under former Public Act 70 of 1982) is exempt from ad valorem real and personal property taxes imposed under the General Property Tax Act while the enterprise is using or occupying the property solely for the purpose of performing research and development in present and emerging technology and its application to business and industry, provided that the enterprise retains its nonprofit status under Section 501(c)(3) of the Internal Revenue Code (IRC).

Under the bill, the exemption would apply to personal property that was leased, owned, and used, or that portion of real property that was leased, subleased, owned, or occupied by a nonprofit research and development enterprise that received or had received financial benefit or support of at least $1.0 million under the Strategic Fund Act or Section 117 of Public Act 291 of 2000 (or under former Public Act 70 of 1982), or that had received at least $1.0 million from an organization with tax-exempt status under Section 501(c)(3) of the IRC, that received financial benefit or support directly or indirectly under the Strategic Fund Act or Section 117 of Public Act 291 of 2000. The exemption would apply while the property was leased, subleased, owned, used, or occupied by the enterprise solely for the purpose of performing or coordinating research and development activities (described above), provided that the enterprise retained its tax-exempt status under Section 501(c)(3) of the IRC.

(Section 117 of Public Act 291 appropriated $50.0 million for fiscal year 1999-2000 to be deposited in the Michigan Core Communities Fund within the Michigan Strategic Fund.

Public Act 70 of 1982 created the Economic Development Authority to encourage economic growth in the State through loans to businesses and municipalities, as well as grants to research and development enterprises under certain conditions. The Act, which created the Research Center Fund, was repealed by the Michigan Strategic Fund Act.)

MCL 125.5074

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

Research and development are essential to the long-term growth of the State's economy, as the generation of new technologies and processes leads to innovation, increases productivity, and opens up new markets and entrepreneurial possibilities. The cost of such R&D is often significant, however, with no immediate return on the investment. The tax exemption offered to nonprofit R&D enterprises under Section 74 of the Michigan Strategic Fund Act is designed to encourage additional research activity in the State, but Section 74 as currently written fails to recognize the changing nature of the research and development sector. Because of the increased cost of conducting research, organizations frequently conduct joint research projects as parts of consortia, and often lease property rather than purchasing facilities. These practices allow enterprises to focus more resources on actual R&D, maximizing the impact of limited funds. Regardless of whether these companies lease or own the property, they are engaged in the same type of work and should receive the same treatment for tax purposes. These organizations may be operating on a small budget, and the money that is diverted to pay taxes could make a difference in the pace and scale of research that is done. The State should allow organizations to use grant money in the most effective way possible, by reducing peripheral costs and ensuring that the largest portion of the funds is used for actual R&D. It makes little sense for the State to award money to an enterprise and then take some of that money back in taxes. By giving the grant to the company, the government has indicated that the firm is pursuing purposes that will benefit the people of Michigan over the long term, and the full amount of that grant should be used for the company's core mission.

The bill also would extend the current exemption to companies that have received at least $1.0 million under Michigan Core Communities grants. In Ann Arbor, an R&D organization named Internet2 received a grant from the Core Communities Program for its work on developing a high-speed network connecting universities. As with grants from the Research Center Fund, grants from the Core Communities Fund are distributed by the Michigan Economic Development Corporation for the common goal of stimulating economic growth in the State. There is no reason to treat this particular institution differently simply because its grant money was funneled through the Core Communities Program rather than through the Research Center Fund.

By addressing these situations, the bill would ensure that a broader range of R&D facilities could qualify for the property tax exemption offered under Section 74.

Response: It does not appear that a large number of enterprises would be affected by this bill, which could be perceived as benefiting a narrow interest.

Opposing Argument

The tax incentive in Section 74 of the Act is tailored specifically to assist businesses that have invested in the State by building or purchasing their own facilities. The exemption should be given only to companies that appear to have made a long-term commitment to operating in Michigan, rather than also to those that are just leasing property and may depart soon. The bill would expand this tax break, reducing tax revenue without achieving any clear and certain benefit in return.

Response: When a new facility is constructed for a firm, there may be significant financial advantages to leasing rather than buying the property. This decision is not an indication of the company's long-term intentions, but simply a reflection of business realities. Frequently, the buildings in question are constructed for a particular tenant and are built to specifications set by that party. The ownership of the property has no bearing on the potential economic benefit of the research being conducted in the facility, and should not be a factor in awarding tax incentives.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

The bill would reduce State and local property tax revenue by an unknown amount and increase School Aid Fund expenditures by an unknown amount. The fiscal impact assumes the wording of the bill is changed so that personal property eligible for the exemption would not have to be both leased and owned. The amount of the impact would depend on the value of the property affected and the millage rate levied against the property. While the enterprise receiving the exemption would have to receive at least $1.0 million in direct support or support from a 501(c)(3) organization (which could have received any amount of support under the Act or Section 117 of Public Act 291 of 2000), no limits are placed on the value of property that could be exempted. School Aid Fund expenditures would increase to offset any reduction in local school operating revenue due to the bill in order to maintain per-pupil funding guarantees.

Fiscal Analyst: David Zin

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