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BILL ANALYSIS

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Senate Bill 926 (as enrolled)
Sponsor: Senator Nancy Cassis
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACT 616 of 2006

Date Completed: 1-18-07

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. Previously, this exemption applied only to enterprises that owned and occupied real property in the State and had received at least $1.0 million from the Research Center Fund under the Act or previous legislation. Research and development facilities that operated on leased property did not qualify for the property tax exemption. In addition, enterprises that received grants from other designated funds, such as the Core Communities Fund, were ineligible for the exemption. 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 was 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. It was suggested that the Act should allow such companies to qualify for the R&D tax exemption.

CONTENT

The bill amended Section 74 of the Michigan Strategic Fund Act (dealing with the Research Center Fund) to modify the criteria for a property tax exemption for nonprofit research and development enterprises that receive or have 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 other sources funded under that section or a 1999-2000 appropriation to the Core Communities Fund.

The bill took effect on January 3, 2007.

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 that is 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).

The bill expanded that exemption to include personal property that is leased or owned, and used, or that portion of real property that is leased, subleased, or owned, and occupied by a nonprofit R&D enterprise, if the enterprise receives or has received financial support or benefit of at least $1.0 million from the funding sources specified above, or from either of the following sources:

-- Funding under Section 117 of Public Act 291 of 2000 (which appropriated $50.0 million for fiscal year 1999-2000 to be deposited in the Michigan Core

Communities Fund within the Michigan Strategic Fund).

-- Funding from an organization with tax-exempt status under Section 501(c)(3) of the IRC, if that organization received financial benefit or support directly or indirectly under the Strategic Fund Act or Section 117 of Public Act 291 of 2000.

The exemption will apply while the property is leased, subleased, owned, used, or occupied by the enterprise solely for the purpose of performing or coordinating research and development activities as specified in the Act, provided that the enterprise retains its tax-exempt status under Section 501(c)(3) of the IRC.

(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 R&D 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 creation of new technologies and processes leads to innovation, increases productivity, and opens up new markets and entrepreneurial possibilities. Such activities often carry a significant cost, with no immediate return on the investment of time and money. 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 the section previously failed 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 using shared equipment and facilities, and often lease property rather than purchasing their own buildings. These practices allow enterprises to focus more of their 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 similar pursuits and should receive the same treatment for tax purposes.

In many cases, these organizations are operating on limited budgets, and money that is diverted to pay property taxes may reduce the pace and scale of research that can be done. If a grant was awarded by the State for a specific purpose, it makes little sense to require the enterprise to return a portion of the grant money in the form of property taxes. Instead, that money should be focused on the enterprise's core mission. The bill will enable 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. 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 bill will permit the full amount of that grant to be used toward that goal, rather than for paying taxes.

In addition, the bill extends the current exemption to companies that have received at least $1.0 million under Michigan Core Communities grants. This provision will benefit such R&D enterprises as Internet2 in Ann Arbor, which received a grant from the Core Communities Program for its work on developing a high-speed network connecting universities, but previously did not qualify for a tax exemption under the Act, because the funding was not awarded through the Research Center Fund or from other specified sources. Grants from the Core Communities Fund, like those from the Research Center 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.

Response: It does not appear that a large number of enterprises will be affected by this bill, which may 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. By expanding this tax break, the bill reduces 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 the awarding of tax incentives.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

The bill will reduce State and local property tax revenue by an unknown amount and increase School Aid Fund expenditures by an unknown amount. The amount of the impact will depend on the value of the property affected and the millage rate levied against the property. While the enterprise receiving the exemption will have to receive at least $1.0 million in direct support or support from a 501(c)(3) organization (which may 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 may be exempted. School Aid Fund expenditures will 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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