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BILL ANALYSIS

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Senate Bill 680 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Randy Richardville
Committee: Economic Development and Regulatory Reform

Date Completed: 7-22-08

RATIONALE

In order to help Michigan's tool and die companies survive in the face of global competition, Public Act 266 of 2003 amended the Michigan Renaissance Zone Act to allow the designation of up to 20 tool and die renaissance recovery zones, and Public Act 276 of 2005 increased the maximum number of these zones to 25. Originally, the designation applied only to property owned by a tool and die company, but Public Act 202 of 2004 extended it to leased property. Thus, property owned or leased by a qualified tool and die business with fewer than 75 employees may be designated as a recovery zone. The designation exempts the company from various taxes--including business taxes, property taxes, and local income tax--for up to 15 years. The Act prohibits a business located and conducting business activity within a renaissance zone from making a payment in lieu of taxes to any taxing jurisdiction, and provides for a reduction of the taxpayer's exemption, deduction, or credit during the last three years of eligibility for those tax breaks.

The Michigan Strategic Fund (MSF) board has designated the maximum allowable 25 tool and die renaissance recovery zones. Evidently, this has helped to stabilize the industry, and some people believe that the limit on the number of zones should be increased. It also has been suggested that the MSF should be authorized to make an exception to the 75-employee limit for companies that entered into an agreement to compensate a local unit for public safety and fire protection, and that the reduction of benefits in the last three years of eligibility should not apply to a tool and die recovery zone with a duration of less than 15 years.

CONTENT

The bill would amend the Michigan Renaissance Zone Act to do all of the following:

- **Increase from 25 to 35 the maximum number of tool and die renaissance recovery zones that the MSF board may designate.**
- **Allow a recovery zone to include a qualified tool and die business with 75 or more full-time employees if it agreed to a payment in lieu of taxes (PILT) for public safety and fire protection services or for school funding.**
- **Exclude a tool and die renaissance recovery zone with a duration of less than 15 years from a provision requiring a reduction in tax breaks during the final three years of renaissance zone designation.**

Tool and Die Recovery Zones

The Act allows the MSF board to designate up to 25 tool and die renaissance recovery zones within Michigan in one or more cities, villages, or townships, if the local unit or a combination of them consents to the creation of a recovery zone within its boundaries. The bill would allow the MSF board to designate up to 35 tool and die renaissance recovery zones.

The Act also allows the MSF board to combine existing recovery zones that consist solely of tool and die businesses that are parties to the same qualified collaborative agreement. Where two or more recovery zones have been combined, the board may continue to designate additional recovery zones, provided that not more than 25 tool and die recovery zones exist at one time. The bill would allow the board to continue to designate additional recovery zones as long as not more than 35 existed at one time.

("Qualified collaborative agreement" means an agreement that demonstrates synergistic opportunities, including all of the following:

-- Sales and marketing efforts.
-- Development of standardized processes.
-- Development of tooling standards.
-- Standardized project management methods.
-- Improved ability for specialized or small niche shops to develop expertise and compete successfully on larger programs.)

<u>Number of Employees & PILT</u>

Currently, under the definition of "qualified tool and die business", a business must have fewer than 75 full-time employees. Under the bill, that requirement would apply except as otherwise provided by the MSF board.

In addition, except as designated under the Act, a business that is located and conducts business activity within a renaissance zone may not make a payment in lieu of taxes to any taxing jurisdiction within the qualified local governmental unit in which the renaissance zone is located. The bill would make an exception to this provision.

Beginning on the bill's effective date, a recovery zone could include a qualified tool and die business that had 75 or more full-time employees, if that business had entered into a written agreement with the MSF board and the local unit or units in which it was located. The agreement could include a PILT to compensate the city, village, or township for public safety and fire protection services provided to the business. The PILT could not exceed the actual costs of providing those services. If the public safety or fire protection services were provided by the county or another public entity instead of the city, village, or township, the PILT would have to be paid directly to the county or other public entity, as provided by the MSF board.

An agreement also could include a PILT to the State of up to the amount the facility would have paid under the State Education Tax Act and the Revised School Code if the facility were not eligible for exemptions, deductions, or credits under the Michigan Renaissance Zone Act. Any amount paid to the State in lieu of taxes would have to be credited to the State School Aid Fund.

<u>Reduction of Exemption, Deduction, or Credit</u>

Under the Act, during the last three years that a taxpayer is eligible for an exemption, deduction, or credit, that exemption, deduction, or credit must be reduced by the following percentages:

-- 25%, for the tax year that is two years before the final year of designation as a renaissance zone.
-- 50% for the tax year immediately preceding the final year of renaissance zone designation.
-- 75% for the tax year that is the final year of renaissance zone designation.

Under the bill, these reductions would not apply to tool and die renaissance recovery zones that had a duration of less than 15 years.

MCL 125.2686 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

Tool and die renaissance recovery zones have been successful in stabilizing the tool and die industry in Michigan. While the tooling industry struggles to remain competitive in a global market, recovery zones have provided opportunities for retention of well-paying industrial jobs in Michigan. Competing with operations in China and other rapidly developing nations will continue to be a challenge for Michigan tool and die businesses, and expanding the State's tool and die renaissance recovery zone program will help them to meet that challenge. Recovery zones, which are not geographic in nature but are based on collaborative agreements between tool and die shops, have been more successful than traditional renaissance zones because they are not limited to one potentially unattractive development location but are designed to meet needs where they exist. The 25 collaborative agreements allowed under the Act have all been designated and, if the program is to continue to benefit Michigan small businesses, the MSF needs the authorization to establish more recovery zones.

Supporting Argument

While current law limits qualified tool and die businesses to operations with fewer than 75 full-time employees, it might be beneficial in some cases to allow the MSF to make exceptions to this standard. For instance, some small operations that now qualify might be in a position to grow. Cutting off their eligibility when they employed 75 workers would discourage growth. Similarly, a company that employs 75 or more workers might be motivated to downsize in order to become eligible for inclusion in a recovery zone collaborative agreement. In other cases, a large operation might work collaboratively with smaller businesses that are eligible for recovery zone tax breaks, but the larger company is not a qualified tool and die business under the Act and, as such, is not eligible for the benefits of renaissance recovery zone status. Indeed, an official with one tool and die business that employs more than 75 full-time workers testified to the Senate Economic Development and Regulatory Reform Committee that his company had to lay off employees for the first time in its 27 years of operation and some of those workers were hired by smaller firms that are qualified tool and die businesses under the Act. By allowing the MSF board to provide qualified status to businesses with 75 or more employees, the bill would help to encourage collaboration between large and small tool and die operations, which would further stabilize the industry's presence and success in Michigan.

In addition, one of the reasons for limiting eligibility for the recovery zone tax breaks to relatively small tool and die operations was the potential revenue loss to local units. Eligible tool and die property continues to receive the benefit of public services, such as police and fire protection, but the local unit does not receive tax revenue from the exempt businesses. Including larger operations in tool and die renaissance recovery zones would result in a larger revenue loss to local units. The bill would address this concern by allowing a recovery zone to include a business with 75 or more full-time employees only if that business entered into a PILT agreement with the MSF board and the local units. That agreement could include a requirement to compensate the city, village, township, or county for public safety and fire protection services. A PILT agreement also could include payment to the State for school operating revenue.

Supporting Argument

The duration of renaissance zone status for a tool and die recovery zone is at least five years and not more than 15 years, as determined by the MSF board. For a zone with a duration of less than 15 years, the MSF board, with the consent of the local unit or units where a qualified tool and die business is located, may extend the renaissance zone status for one or more periods that do not total more than 15 years. Because the Act requires the tax benefit of tool and die recovery zone status to be scaled back during the last three years of the designation, tool and die firms that seek or receive a shorter recovery zone status tend to be penalized. By eliminating that requirement when the duration of a recovery zone is less than 15 years, the bill would remove a disincentive for companies to request a shorter recovery zone status.

Opposing Argument

Economic development programs offering tax breaks to businesses often work to the detriment of counties. For instance, a county may create zones under the Act, but must get consent from a city. Conversely, a city may create a zone but does not need the county's consent even though the county may lose tax revenue as a result of the zone. Some counties reportedly are suffering financially from the loss of revenue in renaissance zones.

Response: Without tool and die recovery zones, and other renaissance zones, more businesses would close or leave the State. This would result in even greater fiscal hardships for counties and other local units. Michigan needs to face the economic challenges posed by other states and nations and balance the detriment of foregone revenue due to the creation of renaissance zones with the losses that would occur if companies went out of business or relocated outside of Michigan.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill would reduce State and local revenue, as well as increase expenditures from the School Aid Fund. Businesses located in the zones are exempt from State and local property taxes, State and local income taxes, local utility taxes, and the Michigan business tax (MBT). By increasing the number of zones, as well as the size of the firms that may be included within a zone, the bill would reduce the revenue from these taxes. The actual amount of any reductions would depend upon the specific characteristics of the properties and businesses affected. Any reduction in local school district revenue from mills levied for operating purposes or mills levied by community colleges would be offset by increased expenditures from the School Aid Fund in order to maintain per-pupil funding guarantees.

Assuming that tool and die firms, on average, are the same as other firms within the nonelectrical machinery sector, if every tool and die firm in Michigan were included within a zone under the changes proposed in this bill, it is estimated that MBT revenue would be reduced by approximately $1.2 million in tax year 2008, and all of this loss in revenue would affect the General Fund. In addition, School Aid Fund revenue from the State education property tax would be reduced an estimated $1.3 million and School Aid Fund expenditures would increase an estimated $4.0 million due to a reduction in the local school 18-mill property tax. Local government property taxes also would be reduced an estimated $9.0 million. There is no way to know at this time how many tool and die firms would be included in a zone. These estimates reflect the estimated fiscal impact of this bill if all tool and die businesses were included in a zone and none participated in a payment-in-lieu-of-taxes agreement, and therefore are estimates of the maximum potential loss in tax revenue.

Fiscal Analyst: David Zin