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BILL ANALYSIS

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House Bill 5898 (Substitute H-2 as passed by the House)
Sponsor: Representative John Moolenaar
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 6-5-08

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to allow a taxpayer that was engaged in the research, development, or manufacturing of photovoltaic energy, photovoltaic systems, and other photovoltaic technology to claim a refundable credit against the MBT, subject to a $100 limit on all credits taken under the bill.

Research & Development Credit

Under the bill, for tax years beginning on or after January 1, 2009, a taxpayer that was engaged in the research, development, or manufacturing of photovoltaic energy, photovoltaic systems, and other photovoltaic technology could claim a credit against the MBT equal to the greater of the following:

-- 50% of the capital investments made by the taxpayer in the research, development, or manufacturing of photovoltaic energy, photovoltaic systems, and other photovoltaic technology in this State during the tax year.
-- 50% of the taxpayer's expenses incurred in this State during the tax year for research and development.

If the credit exceeded the tax liability of the taxpayer for the tax year, the excess portion would be refundable.

The total of all credits allowed under the bill could not exceed $100.

Under the bill, "research and development" would mean qualified research as that term is defined in Section 41(d) of the Internal Revenue Code (IRC). (Under Section 41(d), "qualified research" means research that meets both of the following:

-- It is undertaken for the purpose of discovering information that is technological in nature, and whose application is intended to be useful in the development of a new or improved business component of the taxpayer.
-- Substantially all of the activities constitute elements of a process of experimentation for a purpose related to a new or improved function, performance, reliability or quality, and the research is not for a purpose related to style, taste, cosmetic, or seasonal design factors.

"Qualified research" does not include research after commercial production has begun; research related to the adaptation or duplication of an existing business component; surveys, market research, or routine data testing or inspection for quality control; specified computer software; foreign research; research in the social sciences, arts, or humanities; or research funded by any grant, contract, or otherwise by another person or governmental entity.)

"Photovoltaic cells" would mean an integrated device consisting of layers of semiconductor materials and electric contracts capable of converting incident light directly into electricity. "Photovoltaic modules" would mean an assembly of interconnected photovoltaic cells. "Photovoltaic energy" would mean solar energy. "Photovoltaic systems" would mean solar energy devices composed of one or more photovoltaic cells or photovoltaic modules, and inverter or other power conditioning unit or photovoltaic technology designed to deliver power of a selected current and voltage, wires, and other electrical connectors in order to generate electricity, heat or cool a residential structure, provide hot water for use in a residential structure, or provide solar process heat. Batteries for power storage also could be included in photovoltaic systems.

"Photovoltaic technology" would mean solar power technology that uses photovoltaic cells and modules to convert light from the sun directly into electricity. Photovoltaic technology would include equipment, component parts, materials, electronic devices, testing equipment, and other related systems that are specifically designed or fabricated for one or more of the following:

- The storage, generation, reformation, or distribution of clean fuels integrated within a photovoltaic system.
- The process of using photovoltaic energy to generate electricity for use by consumers.

"Capital investment" would mean the cost, including fabrication and installation, paid or accrued in the taxable year of property of a type that is, or under the IRC will become, eligible for depreciation, amortization, or accelerated capital cost recovery for Federal income tax purposes, provided that the property is physically located in this State for use in a business activity in this State. "Property" would mean "section 1245 property" and "section 1250 property" as those terms are defined in Sections 1245 and 1250 of the IRC. ("Section 1245 property" means any property that is or has been property of a character subject to the allowance for depreciation and is personal property; other tangible property (excluding a building and its structural components) for the period that it was used as an integral part of manufacturing, production or extraction or of transportation, communications, electrical energy, gas, water, or sewage disposal services, or constituted a research facility used in connection with those activities; real property with an adjusted basis in which certain adjustments for amortization are reflected; a single purpose agricultural or horticultural structure; a storage facility used in connection with the distribution of petroleum or any primary product of petroleum; or any railroad grading or tunnel bore. "Section 1250 property" means any real property, other than section 1245 property, that is or has been property of a character subject to the allowance for depreciation provided in the IRC.)

<u>Other Credits</u>

A taxpayer that claimed the credit would not be prohibited from claiming a credit under Section 405, but the taxpayer could not claim both credits based on the same research and development expenses or capital investments. A taxpayer that had entered into an agreement with the Michigan Economic Growth Authority for a credit under Sections 432 through 432d would not be eligible for the credit under the bill.

(Subject to certain limitations, Section 405 allows a taxpayer to claim a credit against the MBT equal to 1.52% of the taxpayer's research and development expenses in this State for the 2008 tax year. For the 2009 tax year and each subsequent tax year, a taxpayer may claim a credit equal to 1.90%.

Sections 432 through 432d, proposed by Senate Bills 1265 through 1270 and House Bills 5972 through 5977, would allow a manufacturer of polycrystalline silicon for solar cells and semiconductor microchips, that constructed and operated a new or expanded facility in Michigan, to claim an MBT credit for 12 years beginning in 2012 for certain energy consumption costs.)

Tie-Bar

The bill is tie-barred to House Bill 5524, which would amend Public Act 3 of 1939, the Public Service Commission law, to address issues pertaining to certificates of necessity, administrative procedures, standards for integrated resource plans, electric rates for utilities with more than 1.0 million Michigan customers, rates for smaller utilities, alternative electric suppliers, and open access service, among other things.

Proposed MCL 208.1430 Legislative Analyst: Craig Laurie

FISCAL IMPACT

The bill would reduce Michigan business tax revenue by a maximum of $100 per year beginning with the 2009 tax year. The low cost of this credit would be due to the provision in the bill limiting the total amount of credits that could be granted during a tax year to a maximum of $100. This proposed credit, with the $100 cap, clearly would not encourage any new business activity in Michigan; however, absent the cap, the proposed refundable credit likely would result in a significant loss in Michigan business tax revenue. A reasonable estimate of the cost of this proposed credit, without the cap, cannot be made because there is no way to know how much businesses will spend on photovoltaic-related capital investments and research and development in Michigan and how much of this new business activity would qualify for the proposed credit; however, it is estimated that this proposed refundable credit, without the $100 cap, would be very costly because it would cover 50% of a qualifying company's up-front capital expenses, as well as 50% of a business's ongoing research and development expenses.

House Bill 5898 (H-2) is tie-barred to House Bill 5524, which is part of the electric restructuring package that was passed by the House. To the extent that this electric restructuring package would increase the demand for alternative energy suppliers, which would include solar energy, the resulting increased solar energy activity in Michigan would add to the potential cost of the proposed credit.

The Hemlock Semiconductor Corporation, which is located in Hemlock, Michigan, and is the world's largest producer of polycrystalline silicon, which is needed to make solar energy cells, has completed about $500 million of a planned $1.5 billion expansion of its existing Michigan operations. If the proposed credit were currently in effect, without the $100 cap, the Hemlock Semiconductor Corporation potentially would qualify for a $200 million to $250 million credit and likely would qualify for additional large credits over the next few years; however, a provision in House Bill 5898 (H-2) would make the Hemlock Corporation ineligible for this credit if it were to receive a credit to help cover its electricity expenses that is currently being proposed in Senate Bills 1265-1270 and House Bills 5972-5977.

Even if the Hemlock Semiconductor Corporation would not be eligible for this proposed credit, the expansion of its operations in combination with the electric restructuring package and this proposed credit could attract a significant amount of new photovoltaic-related business activity in Michigan that likely would be eligible for this credit. However, it is estimated that the new tax revenue that would be generated by any increase in photovoltaic-related business activity would not come close to offsetting the potentially significant cost of this proposed credit (without the $100 cap). The loss in Michigan business tax revenue that would occur under this bill would reduce the General Fund/General Purpose budget and would have no direct impact on local governments.

Fiscal Analyst: Jay Wortley

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