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BILL ANALYSIS

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Senate Bill 773 (Substitute S-6 as passed by the Senate)
Senate Bill 774 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 9-21-09

RATIONALE

The Michigan Economic Growth Authority (MEGA) Act is designed to promote business growth and job creation in the State by offering Michigan Business Tax (MBT) credits to firms that create and maintain jobs in Michigan. Many feel that awarding these credits has been an effective economic development tool and resulted in business location and job creation in Michigan that would not have occurred without the credits. For tax credits for businesses other than qualified high-technology businesses, distressed businesses, rural businesses, and certain other businesses eligible for an MBT credit, in any one year MEGA may not execute tax credit agreements that grant more than 400 yearly credits over the terms of those agreements. Tax credits awarded by MEGA in 2009 reached that annual limit in July, and some people believe that MEGA should be statutorily authorized to award more MBT credits. It also has been suggested that the number of annual tax-credit agreements for high-technology or rural businesses be increased, that MEGA's reporting requirements be expanded, and that other requirements of the tax-credit program be revised.

CONTENT

Senate Bill 773 (S-6) would amend the Michigan Economic Growth Authority Act to do the following:

- **Revise the annual limits on new agreements for MBT credits.**
- **Revise and expand the requirements for MEGA's annual report to the Legislature.**
- **Require the Auditor General to audit and comment on the annual report before MEGA submitted it.**
- **Require the mandatory tax-credit cost/benefit analysis to include an analysis of the competitive relationship between an eligible business and businesses already located in Michigan.**
- **Prohibit MEGA from advocating one Michigan location over another for political purposes.**
- **Require a qualified high-technology business to demonstrate that at least 10% of its total operating expenses in the last two years was attributable to research and development.**
- **Require an eligible business that is a high-wage activity to pay at least 300% of the State minimum wage, rather than of the Federal minimum wage, for each qualified new job.**
- **Prescribe a financial penalty for a business's misrepresentation in its application to MEGA for an MBT credit.**
- **Prohibit MEGA from entering into an agreement for MBT credits under the limit for high-technology or rural businesses if the business had claimed a film tax credit.**
- **Revise the definition of "full-time job" for certain authorized businesses in a bankruptcy proceeding.**

Senate Bill 774 (S-2) would amend the Michigan Business Tax Act to establish a limit on the total amount of MBT credits certified by MEGA that could be claimed annually.

Senate Bill 773 (S-6) is tie-barred to Senate Bills 70 and 774. Senate Bill 774 (S-2) is tie-barred to Senate Bills 70, 71, and 773 and House Bill 4922 (which is similar to Senate Bill 773).

(Senate Bill 70 (S-1), as passed by the Senate, would amend the revenue Act to require the State Treasurer to divulge certain information concerning the MBT Act to the chairpersons of the Senate and House standing committees with jurisdiction over matters relating to taxation and finance, and to the directors of the Senate and House Fiscal Agencies. Senate Bill 71 (S-1), as passed by the Senate, would amend the MEGA Act to revise and expand the requirements for MEGA's annual report to the Legislature and require the Auditor General to audit and comment on the report before MEGA submitted it.)

Senate Bill 773 (S-6)

Requirements for Tax Credit

The MEGA Act allows the Michigan Economic Growth Authority to enter into an agreement with an eligible business for a credit against the tax imposed by the MBT Act. "Eligible business" means a distressed business, a business that proposes to maintain retained jobs or create qualified new jobs in Michigan in manufacturing, mining, research and development, wholesale and trade, film and digital media production, or office operations, or a business that is a qualified high-technology business, a tourism attraction facility, or a qualified lodging facility.

After receiving an application, MEGA may enter into an agreement with an eligible business for a tax credit if the Authority determines that certain requirements are met. Under that provision, MEGA must determine that a cost/benefit analysis reveals that authorizing the eligible business to receive tax credits will result in an overall positive fiscal impact to the State.

Under the bill, the cost/benefit analysis would have to include an analysis of the competitive relationship of the eligible business to competing businesses already located in Michigan. If the analysis indicated substantial competition with one or more businesses already located in the State, MEGA would have to disclose their names and addresses to the Legislature, legislators, and the Senate and House Fiscal Agencies in the same manner as required for the Authority's annual report (described below).

Also, MEGA currently must determine that a qualified high-technology business agrees that at least 25% of its total operating expenses will be maintained for research and development for the first three years of the agreement. Under the bill, MEGA instead would have to determine that a qualified high-technology business demonstrated that at least 10% of its total operating expenses in the immediately preceding two years was attributable to research and development.

In addition, MEGA currently must determine that, for an eligible business that is a high-wage activity, the wage paid for each qualified new job is at least 300% of the Federal minimum wage. Under the bill, the requirement would be 300% of the State minimum wage.

The bill also would prohibit MEGA from advocating one location over another in Michigan for political purposes.

Among other things, a written agreement between an eligible business and MEGA must include a statement by the business that a misrepresentation in its application may result in the revocation of the designation as an authorized business and the refund of credits received under the Act. Under the bill, the penalty could be revocation and the refund of credits received plus a penalty equal to 10% of those credits.

Maximum Annual Credits Allowed

General Limit. The Act prohibits MEGA each year from executing new written agreements that, in total, provide for more than 400 yearly credits over the terms of those agreements entered into that year for eligible business that are not qualified high-technology businesses, distressed businesses, rural businesses, or other specified businesses. Under the bill, that limit would apply through December 31, 2008.

For 2009, MEGA could not execute new written agreements that, in total, provided for more than 400 yearly credits over the terms of the agreements entered into that year, plus up to 85 additional yearly credits previously issued by the Authority. For 2010 and subsequent calendar years, MEGA could not execute new written agreements that, in total, provided for more than 300 yearly credits over the terms of the agreements entered into that year, plus up to 85 additional yearly credits previously issued by the Authority.

"Credits previously issued" would mean two-thirds of the number of tax credits authorized by MEGA for an authorized business beginning in 1999 that met all of the following:

-- The authorized business did not use any of the tax credits authorized under the written agreement.
-- The authorized business no longer qualified as an authorized business under a specific written agreement, as determined by MEGA.
-- The Authority determined at a meeting upon a majority vote of members present that the credits previously authorized satisfied both of those criteria.

High-Tech & Rural Businesses. Under the Act, MEGA may not execute more than 50 new written agreements each year for eligible businesses that are qualified high-technology businesses or rural businesses. Only 25 of those agreements may be executed each year for qualified rural businesses. Under the bill, MEGA could not execute more than 75 new written agreements each year for qualified high-technology or rural businesses, and only 35 of them could be for rural businesses.

Also, only 50 of the written agreements for businesses that were qualified high-technology businesses or rural businesses could be executed each year for a high-technology business that engaged in a qualified high-wage activity. Only four of the 75 agreements could provide for a tax credit with a duration of more than 12 years but not more than 20 years.

In addition, MEGA could not execute a written agreement for an eligible business that was a qualified high-technology business or rural business under the 75-agreement limit if that eligible business had claimed a credit under Section 455 of the MBT Act (which allows the Michigan Film Office, with the concurrence of the State Treasurer, to enter into an agreement for tax credits with an eligible production company).

Report to the Legislature

The MEGA Act requires MEGA to report to the Senate and the House annually, by October 1, on its activities. Under the bill, beginning on October 1, 2009, and each subsequent year, MEGA also would have to report to the chairpersons of the Senate and House Appropriations Committees, the chairperson of the Senate Finance Committee, the chairperson of the House Tax Policy Committee, and the directors of the Senate Fiscal Agency (SFA) and House Fiscal Agency (HFA). The Authority also would have to report to those chairpersons or directors upon their written request.

The Act specifies information that must be included in the annual report. This includes the total number of new written agreements entered into and, of those written agreements, the number in which MEGA determined that it was in the public interest to waive one or more of the general requirements for entering into an agreement. The bill would require the report also to include the total capital investment for the credit under written agreements entered into under the Act.

In addition, the bill would require the report to include the following for each written agreement with each authorized business:

-- The actual number of jobs created or retained for both the most recent period that information was available and all previous years under that agreement.
-- The total capital investment at that facility for tax credits authorized for both that year and all previous years under the agreement.
-- The total value of the tax credits received under that written agreement for both that year and all previous years under the agreement.

The report also would have to include all of the following:

-- The number of jobs required under written agreements to be created or retained for each authorized business to be eligible for the tax credits under the agreements.

-- A copy of each tax credit certificate issued under the MBT Act for credits authorized by MEGA.
-- The identity of each authorized business and the number of yearly credits identified as "credits previously issued" under the bill's formula for determining the number of credits allowed annually.
-- A detailed analysis of the cost differential to the business between expanding, locating, or retaining new jobs in Michigan and a site outside of Michigan.

Before MEGA submitted the report, the bill would require the Auditor General to audit it and include comments about the audit with the report.

Full-Time Job

Under the Act, a full-time job must be performed by an individual for at least 35 hours each week, and income and Social Security taxes must be withheld.

Under the bill, beginning January 1, 2009, for a period of two years as determined by the authorized business, "full-time job" also would mean a job performed by an individual for at least 30 hours each week and for which health care benefits were provided and income and Social Security taxes were withheld by an authorized business that was a debtor-in-possession in a bankruptcy proceeding in the last five years; was subject to a collective bargaining agreement; and met requirements under the Act for economically sound plans for expansion, retention, or location and for confirmation of a Chapter 11 reorganization plan by the bankruptcy court within six years of the date of the business's agreement with MEGA.

Senate Bill 774 (S-2)

Section 431 of the MBT Act allows a taxpayer that is an authorized business to claim an MBT credit equal to the amount certified each year by MEGA, for up to 20 years as determined by MEGA, for all or a portion of the business's payroll and, in some cases, health care benefits.

Under the bill, for 2010 and each subsequent calendar year, the total amount of all credits allowed to be claimed in the first year of all agreements approved under Section 431 could not exceed the sum of the total amount of credits claimed under that section during the immediately preceding calendar year plus $95.0 million.

MCL 207.808 & 207.810 (S.B. 773)
208.1431 (S.B. 774)

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 MEGA tax credit program provides an incentive that helps Michigan to compete with other states in attracting new business ventures and in retaining and creating new jobs. This economic development tool has been used extensively by the Michigan Economic Development Corporation (MEDC), which provides staff for MEGA, partnering with local economic development corporations. It is important to allow the MEDC and MEGA to continue the tax credit program, and even to expand its use, because every other state has similar, and often better, programs to attract new business development. Some states reportedly even offer cash payouts and land grants, up-front, while the MEGA system offers after-the-fact tax credits. Awarding tax credits may not be as enticing as the initial benefits some other states offer but, by spreading tax breaks out over multiple years, it encourages a long-term commitment to a business presence and job growth in Michigan. The MEGA tax-credit system also ensures that new and expanding businesses will meet certain benchmarks, generally in terms of job retention or growth and capital investment, or they will not be eligible to collect tax credits awarded to them.

As mentioned above, the MEDC awarded the maximum amount of MEGA credits authorized for a calendar year just seven months into 2009. This reflects the popularity of the program and suggests promising results for Michigan's economy in future years. It also suggests that the annual cap for MBT credits awarded by MEGA for businesses that are not high-technology, rural, or distressed businesses (known as "regular" MEGA credits) is insufficient. Indeed, more businesses are lined up to begin projects in Michigan as soon as MEGA tax credits can be awarded. One project involves two alternative energy companies' joint venture to purchase and redevelop the former Ford Motor Company plant in Wixom for an energy storage venture that would locate around 4,000 jobs at or near the site and a solar-panel manufacturing operation that would involve about $275 million in capital investment. The two companies also would develop the rest of the large Ford Wixom plant for lease to other alternative energy entrepreneurs. In addition, a solar energy company will be visiting the Saginaw Bay region to consider an investment there, according to written testimony submitted to the Senate Finance Committee by the president of Saginaw Future, a nonprofit economic development organization in Saginaw County that is partnering with Midland and Bay Counties and the MEDC. The solar energy company reportedly has been offered $2.0 million cash from the State of Texas, but an incentive package that would include MEGA tax credits could entice the company to locate in Michigan instead. This project evidently is expected to result in 500 new jobs and over $175 million in capital investment. Developments such as these alternative energy ventures would help to jump-start and diversify Michigan's sluggish economy.

By authorizing MEGA to award more tax credits, based on a percentage of tax credits previously awarded but not used, Senate Bill 773 (S-6) would accommodate the demand for more MEGA-issued MBT credits in 2009, allowing business ventures like those proposed in Wixom and the Saginaw Bay area to move forward. The bill also would allow MEGA to award credits beyond the statutory yearly limit in 2010 and subsequent years, based on those previously issued but unused credits, which would facilitate future economic development efforts. In addition, under the bill, significantly more MEGA credits could be issued for high-technology and rural businesses, allowing Michigan to compete with other states for those types of developments.

Response: Similar legislation (House Bill 4922 (H-1) as passed by the House) proposes to increase the annual cap for MEGA-awarded MBT credits from 400 yearly credits over the terms of the agreements to 500 yearly credits. Setting the annual cap for the amount of MEGA credits that may be awarded based on what credits may or may not have been claimed in previous years, as Senate Bill 773 (S-6) proposes, could be problematic for businesses desiring to locate or expand in Michigan. Under that system, the cap would vary from year to year, leaving businesses unsure about whether the incentive would be available to them. In addition, as businesses became successful in claiming MEGA-awarded credits, fewer credits would be available under the "previously issued" portion of the formula. Indeed, the bill would decrease the number of credits available in 2010 and beyond, by allowing only 300 yearly credits plus a percentage of previously issued but unused credits. To attract more future business investment to the State, the bill should simply increase the number of yearly credits that MEGA may award annually.

Supporting Argument

Over the years, amendments to the MEGA Act have made it less restrictive. As a result, the Legislature may have more limited oversight of the MEDC's activities in evaluating companies for MBT credits and making recommendations to MEGA. In addition, according to a policy brief published by the Mackinac Center for Public Policy ("MEGA, the MEDC and the Loss of Sunshine", 7-29-09), over time "information contained in MEGA's various reports has become increasingly vague and incomplete". This can make it difficult for policy-makers and others to measure the cost and effectiveness of the tax-credit program.

In order for the Legislature to provide sufficient oversight, and for the public to be better informed as to the State's economic development efforts, the MEGA program should be more transparent. To that end, Senate Bill 773 (S-6), together with Senate Bill 71, would expand the information that must be included in MEGA's annual report to the Legislature, require that the report be sent to the chairs of legislative committees dealing with taxation and finance and to the directors of the SFA and HFA annually or as they requested, and require the Auditor General to review and comment upon the annual report before MEGA submitted it.

Supporting Argument

Senate Bill 774 (S-2) would establish a limit on the annual growth in the value of MEGA tax credits awarded. In recent years, State revenue growth has been stagnant, and even in decline. Limiting the annual increase in the total value of MEGA-awarded MBT credits would recognize both the reality of this situation and that many other programs and services compete for the State's limited resources.

Opposing Argument

The MEDC and the MEGA tax-credit program should be eliminated, not expanded. The program has failed to deliver on promised results and may even be contributing to Michigan's economic and budgetary woes. According to a recently released Mackinac Center for Public Policy study ("The Michigan Economic Development Corporation: A Review and Analysis", 8-31-09), MEGA deals were expected to produce 61,043 jobs from tax credits awarded between 1995 and 2004, but only 17,971—or less than one-third—ultimately were created. In addition, the Mackinac Center commissioned an economist from Ball State University to analyze the MEGA tax-credit program by evaluating the relationship between a county's manufacturing employment and the dollar value of MEGA credits actually awarded to companies in that county. The economist actually found a negative statistical relationship between MEGA manufacturing credits and county manufacturing employment: From 2001 to 2007, every $1.0 million in MEGA manufacturing tax credits awarded in a county was associated with the loss of 95 manufacturing jobs in the county. Although MEGA has offered more than $3.3 billion in business tax credits since its inception in 1995, MEDC programs have failed to create new and retain existing jobs for Michigan workers. Eliminating the MEDC and the programs it administers, including MEGA, could save tens of millions of dollars that could be used to balance the State's budget without raising taxes.

In addition, cumulative statewide job losses have far exceeded the cumulative direct jobs created in Michigan since 2001, and the State's unemployment rate has steadily increased over that period, despite a steady increase in the cumulative amount of MEGA tax credits granted in that time. This suggests that the MEDC's economic development efforts, particularly the MEGA tax-credit program, have failed to improve Michigan's economic performance.

Response: The Mackinac Center study compares jobs created with those expected from *awarded* MEGA tax credits, not the credits that actually were *claimed*. In fact, by 2008, the value of MEGA tax credits actually claimed was considerably less than half of the value of credits awarded. Credits may be awarded but not claimed for such reasons as failure of the business to meet the eligibility requirements to claim the credit or failure of the business venture even to get off the ground. Also, the downward trend in Michigan jobs and the increase in the State's unemployment rate coincide with broader economic stresses, such as increasing globalization of production and markets, advances in technology, and the recent worldwide recession (particularly in the manufacturing sector), none of which can be attributed to MEGA tax credits or any other MEDC program. Indeed, a case could be made that Michigan's economy and budgetary problems would be even worse without the use of MEGA tax credits.

Opposing Argument

In order to be effective in attracting business development to Michigan, the State must have an incentive system that is competitive with other states' economic development measures. Senate Bill 773 (S-6) is simply too restrictive to allow MEGA to compete with other states' efforts to promote business location and retention and job creation. For instance, the bill's requirement that the cost/benefit analysis examine competition with businesses already located in Michigan could preclude attracting some business development opportunities to the State. Also, the prohibition against MEGA's advocating one Michigan location over another could stifle efforts to attract businesses to struggling areas. Michigan should be trying to strengthen the MEGA tax-credit program, but the bill could hinder the MEDC's ability to compete with other states' economic development efforts.

Response: The Legislature needs to exercise appropriate oversight of economic development programs, including protecting established Michigan businesses. Tax-paying Michigan companies are put at a competitive disadvantage relative to new companies that receive a tax break. This is unfair to good corporate citizens that have supported the State through their continued operation in Michigan and payment of their fair share of taxes. Also, bureaucratic advocacy of one area of the State over another just pits local units against each other. The perception of political favoritism of one local unit over another should be avoided.

Opposing Argument

A previous Senate substitute for Senate Bill 773 included a requirement that MEGA determine that, except for a qualified high-technology business, an eligible business's expansion, retention, or location in Michigan would not occur without the MBT credits offered under the MEGA Act. A similar provision used to be in the Act and should be reinstated to ensure judicious use of the State's resources. This is widely referred to as the "but for" clause, meaning the tax credit recipient would not choose to locate or expand, or retain jobs, in Michigan but for the tax credits. If a business planned to locate or expand in Michigan regardless of whether it received tax credits, then it would not need nor should it receive an incentive. Michigan's MEGA credits should be used to encourage business growth in the State, when necessary to compete with other states. They should not be handed out with little discretion, as suggested by the fact that MEGA reached its annual cap in just seven months.

Response: The previous "but for" requirement was removed from the Act because, in effect, it required businesses to seek incentive deals from other states in order to qualify for MEGA credits. Often, business officials resented having to seek and document an offer from another state, even if they had already decided they wanted to do business in Michigan. Sometimes, those companies received better offers and decided to locate elsewhere, meaning the "but for" clause actually drove businesses out of Michigan. In theory, a "but for" requirement may seem sensible, but in practice it simply did not work.

Moreover, the MEDC does not indiscriminately hand out MEGA tax credits. According to testimony before the Senate Finance Committee, applicants undergo a rigorous review process, including a requirement that they conduct a cross-state comparison of tax rates and other data to demonstrate the need for an incentive to compete with other states.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

Senate Bill 773 (S-6)

The bill would reduce General Fund revenue from the Michigan Business Tax by an unknown amount. The amount of reduction would depend upon the specific characteristics of the credits granted to affected taxpayers, as well as the specific characteristics of their performance. The penalty in the bill would increase revenue by an unknown amount, depending on how many taxpayers were penalized. That increase, however, is expected to be more than offset by the increased number of credits authorized under the bill. Credits authorized under the section affected by the bill are expected to total $94.6 million during fiscal year 2008-09.

Senate Bill 774 (S-2)

The bill would limit the growth in credits authorized under the statute. The growth in awarded credits (which results in a reduction in revenue) would be limited to the amount of credits claimed in the immediately preceding year plus $95.0 million. The limit would apply only to the value of credits in the first year the agreements were approved and apparently would not apply to later years. As a result, revenue would be expected to decline, and could decline by more than $95.0 million in an individual fiscal year.

Fiscal Analyst: David Zin

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