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BILL



ANALYSIS

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Senate Bill 838 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Michael Switalski
Committee: Finance

Date Completed: 10-13-09

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to:

- **Phase out the MBT surcharge, eliminating it for tax years after 2011, and reduce the amount that may be levied on a taxpayer in a tax year from \$6.0 million to \$2.0 million by 2011.**
- **Reduce the credit for film production expenditures, reduce the amount allowed for individual compensation, and limit the total credits allowed in a year for commercials unrelated to qualified productions.**
- **Increase the credit allowed for investment in film and media infrastructure projects.**
- **Increase the income limits of taxpayers eligible for the small business credit.**
- **Extend the entrepreneurial credit to the 2011, 2012, and 2012 tax years, and reduce the minimum number of new jobs and amount capital investment required for that credit.**
- **Exclude from gross receipts 100% of the excise taxes paid by a person on or for cigarettes or tobacco products.**
- **Reduce the total annual amount of brownfield credits for projects costing not more than \$10.0 million.**
- **Require an additional \$100.0 million of revenue collected under the Act to be distributed to the School Aid Fund in fiscal year 2009-10.**

Surcharge

In addition to the taxes levied under the Act, Section 281 imposes an annual surcharge on

taxpayers. The surcharge is equal to a percentage of a taxpayer's tax liability under the Act after allocation or apportionment to this State but before the calculation of various credits. The surcharge does not apply to a person subject to the tax under Chapter 2A (an insurance company) or to a person subject to the tax under Chapter 2B (a financial institution) that is authorized to exercise only trust powers.

For each taxpayer other than a financial institution, the surcharge is equal to 21.99% of the taxpayer's liability. For a financial institution (except one that may exercise only trust powers), the surcharge is equal to 27.7% for tax years ending during 2008, and 23.4% for tax years ending after 2008.

Under the bill, for a taxpayer other than a financial institution, the surcharge would be as follows:

- For tax years ending after December 31, 2007, and before October 1, 2009: 21.99%.
- Between October 1, 2009, and December 31, 2010: 14.66%.
- For tax years ending in 2011: 7.33%.

For a financial institution, the surcharge would be as follows:

- For tax years ending in 2008: 27.7%.
- For tax years ending after December 31, 2008, and before October 1, 2009: 23.4%.
- Between October 1, 2009, and December 31, 2010: 15.6%.
- For tax years ending in 2011: 7.8%.

Currently, the amount of the surcharge levied on any taxpayer may not exceed \$6.0 million for any single tax year. Under the bill, that limit would be as follows:

- \$6.0 million for the 2008 tax year.
- \$5.5 million for the 2009 tax year.
- \$4.0 million for the 2010 tax year.
- \$2.0 million for the 2011 tax year.

The amendments to Section 281 would be retroactive and effective for taxes levied after September 30, 2009.

Film Credits

Production Expenditures. Section 455 of the Act authorizes the Michigan Film Office, with the concurrence of the State Treasurer, to enter into agreements with eligible production companies for a refundable MBT or income tax credit. (An eligible production company is an entity in the business of producing "qualified productions", such as motion pictures, television series, music videos, video games, and digital animation.) To qualify for the credit, a production company must spend at least \$50,000 in Michigan for the development, preproduction, production, and postproduction costs of a State-certified qualified production. If a production company meets the terms of its agreement, the Film Office must issue a postproduction certificate of completion to the company, which must submit the certificate to the Department of Treasury.

The amount of a credit is equal to 42% of direct production expenditures for a qualified production in a "core community", 40% of those expenses for a qualified production elsewhere, and 30% for qualified personnel expenditures. (A core community is a qualified local governmental unit as defined in the Obsolete Property Rehabilitation Act.)

Under the bill, the credit would be equal to 39% of direct production expenditures for a production in a core community, 37% of those expenditures for a production elsewhere, and 30% for qualified personnel expenditures. For each calendar year beginning with 2010, however, the total of all credits for all postproduction certificates of completion issued for commercials eligible as qualified productions during the year could not exceed \$15.0 million.

The Act's definition of "qualified production" includes commercials. Under the bill, the definition would include a commercial only if 75% of the production of the commercial takes place in this State. Currently, "qualified production" does not include a production that primarily markets a product or service other than a State certified qualified production. Under the bill, this exclusion would not apply to a commercial otherwise eligible as a qualified production.

The Act defines "direct production expenditure" as "a development, preproduction, production, or postproduction expenditure made in this state that is not a qualified personnel expenditure directly attributable to the production or distribution of a qualified production that is a transaction subject to taxation in this state". The term includes expenditures for distribution, including production costs relating to the creation of commercials. The bill would refer to commercials other than commercials that are eligible as a qualified production.

The definition also includes payments and compensation, not to exceed \$2.0 million for any one employee or contractual or salaried employee who performs services in this State for the production or distribution of a qualified production. Under the bill, the \$2.0 million limit would apply in 2008 and 2009. In each subsequent year, the limit would be \$1.0 million. The bill also would refer to a producer, as well as any one employee or contractual or salaried employee.

The Act's definition of "qualified personnel expenditure" refers to a payment or compensation payable for below-the-line crew members who were not residents of this State for at least 60 days before approval of the agreement for the qualified production, not to exceed \$2.0 million for any one employee or contractual or salaried employee who performs service in this State for the production of a qualified production. Under the bill, the payment or compensation would have to be for below-the-line crew members who were residents of the State for at least 180 days before approval of the agreement. The \$2.0 million limit would apply in 2008 and 2009. In each subsequent year, the limit would be \$1.0 million. The bill also would refer to a producer, as well as any one employee or contractual or salaried employee.

The amendments to Section 455 would be effective for tax years beginning after December 31, 2009.

Infrastructure Projects. Section 457 of the Act allows the Film Office, with the State Treasurer's concurrence, until September 30, 2015, to enter into a tax credit agreement with a taxpayer who invests at least \$100,000 before 2009, or at least \$250,000 after 2008, in a qualified film and digital media infrastructure project.

The taxpayer may claim a credit equal to 25% of its base investment. The bill would increase that percentage to 32%. ("Base investment" refers to the cost of tangible assets that are physically located in Michigan for use in a business activity in this State and are not mobile tangible assets used by a person in the development of a qualified film and digital media infrastructure project.)

The amendment to Section 457 would be effective for tax years beginning after December 31, 2009.

Small Business Credit

Section 417 of the Act allows a credit against the MBT for any taxpayer with gross receipts that do not exceed \$20.0 million and with adjusted business income minus a loss adjustment that does not exceed \$1.3 million as adjusted annually for inflation using the Detroit consumer price index (CPI). The credit is the amount by which the MBT exceeds 1.8% of adjusted business income.

The bill would revise this credit as described below.

Also, under the bill, adjusted business income minus the loss adjustment could not exceed \$1.4 million, rather than \$1.3 million, as adjusted annually for inflation using the Detroit CPI.

The amendments to Section 417 would be effective for tax years beginning after December 31, 2009.

Disqualification. An individual, partnership, limited liability company (LLC), or subchapter S corporation is disqualified if the individual, any one partner of the partnership, any one member of the LLC, or

any one shareholder of the S corporation receives more than \$180,000 as a distributive share of the adjusted business income minus the loss adjustment of the individual, partnership, LLC, or S corporation.

A corporation other than an S corporation is disqualified if compensation and directors' fees of a shareholder or officer exceed \$180,000 or if the sum of the following amounts exceeds \$180,000 for the respective tax year:

- Compensation and directors' fees of a shareholder.
- The product of the percentage of outstanding ownership or of outstanding stock owned by that shareholder multiplied by the difference between the sum of business income and, to the extent deducted in determining Federal taxable income, a carry-back or a carry-over of a net operating loss or capital loss, minus the loss adjustment.

The bill would change the \$180,000 amounts to \$182,000 as adjusted annually for inflation using the Detroit CPI.

Reduction. Subject to a reduction percentage, the credit must be reduced by the following percentages if 1) an individual, any one partner of a partnership, any one member of an LLC, or any one shareholder of a subchapter S corporation receives as a distributive share of adjusted business income minus the loss adjustment of the individual, partnership, LLC, or subchapter S corporation; 2) compensation and directors' fees of a shareholder or officer of a corporation other than a subchapter S corporation are; or 3) the sum used to determine disqualification for a corporation other than an S corporation is:

- More than \$160,000 but less than \$165,000: 20%.
- \$165,000 or more but less than \$170,000: 40%.
- \$170,000 or more but less than \$175,000: 60%.
- \$175,000 or more but not more than \$180,000: 80%.

The bill, instead, would require the credit to be reduced by 10% for more than \$164,000 but less than \$166,000, and by an additional 10% for each additional \$2,000 up to

\$182,000. The dollar amounts would have to be adjusted annually for inflation using the Detroit CPI.

Entrepreneurial Credit

Under Section 441 of the Act, for the 2008, 2009, and 2010 tax years, except as otherwise provided, a taxpayer may claim the Michigan entrepreneurial credit equal to 100% of the taxpayer's MBT liability attributable to increased employment (the creation or transfer of new jobs) for three years if the taxpayer meets all of the following conditions:

- Had less than \$25.0 million in gross receipts in the immediately preceding tax year, annually adjusted for inflation using the Detroit CPI.
- Has created in this State or transferred into this State at least 20 new jobs in the immediately preceding tax year.
- Has made a capital investment in this State of at least \$1.25 million in the immediately preceding tax year (not including the purchase of an existing plant or the purchase of existing equipment).
- Is not a retail establishment as described in Major Groups 52 through 59 and 70 under the Standard Industrial Classification Code as compiled by the U.S. Department of Labor, subject to an exception for a new restaurant.

The bill would extend these provisions to the 2011, 2012, and 2013 tax years, and allow the credit for liability attributable to increased employment for "each year", rather than for three years. The existing criteria would apply to the 2008 tax year. For each tax year after 2008 that the credit was available, the bill would reduce the number of new jobs that a taxpayer must create or transfer into the State from 20 to eight, and would lower the minimum capital investment from \$1.25 million to \$500,000.

The amendments to Section 441 would be retroactive and effective for tax years beginning after December 31, 2008.

Tobacco Products

Under Section 111 of the Act, a business must pay tax on amounts defined as "gross receipts", which include certain taxes collected by businesses on behalf of the

State. In the case of receipts from the sale of cigarettes or tobacco products by a wholesale dealer, retail dealer, distributor, manufacturer, or seller, to the extent not deducted as purchases from other firms, Section 111 gradually excludes from gross receipts an amount equal to the Federal and State excise taxes paid by a person on or for the cigarettes or tobacco products.

The exclusion is phased in over a three-year period: 60% of the amount in the 2008 tax year; 75% in the 2009 tax year; and 100% in the 2010 tax year and each subsequent tax year. The bill would delete the phase-in.

The amendment to Section 111 would be retroactive and effective for tax years beginning after December 31, 2007.

Brownfield Credits

Section 437 of the Act establishes criteria under which qualified taxpayers may claim credits against the MBT for a percentage of eligible investment in brownfield property (property that is contaminated, functionally obsolete, or blighted). In order to claim a credit, a taxpayer must obtain approval of the project from the Michigan Economic Growth Authority (MEGA). Separate approval procedures apply to projects costing \$2.0 million or less, more than \$2.0 million but not more than \$10.0 million, or more than \$10.0 million.

For the 2008 calendar year, the total of all credits for all approved projects costing not more than \$10.0 million could not exceed \$63.0 million, and for each subsequent year the total of all of those credits may not exceed \$40.0 million.

The bill would retain the \$40.0 million limit for 2009. For each subsequent year, the total of all credits for all approved projects costing not more than \$10.0 million could not exceed \$30.0 million.

The amendments to Section 437 would be effective for tax years beginning after December 31, 2009.

School Aid Fund Distribution

Under Section 515 of the Act, in fiscal year (FY) 2008-09, \$729.0 million of the revenue collected under the Act must be distributed

to the School Aid Fund and the balance must be deposited in the General Fund. For each fiscal year after FY 2008-09, that amount from the preceding fiscal year as adjusted by an amount equal to the growth in the U.S. CPI must be distributed to the School Aid Fund, and the balance deposited in the General Fund.

Under the bill, in addition to this distribution, in FY 2009-10, \$100.0 million of the revenue collected under the Act would have to be distributed to the School Aid Fund.

The amendment to Section 515 would be retroactive and effective for taxes levied after September 30, 2009.

Tie-Bars

The bill is tie-barred to Senate Bill 1, which would amend the MBT Act to decrease the surcharge by 50% for tax years ending in 2009 and eliminate it for subsequent tax years.

The bill also is tie-barred to Senate Bill 69, which would amend the MBT Act to increase the income limits affecting eligibility for the small business credit; extend the entrepreneurial tax credit to the 2011, 2012, and 2013 tax years; and reduce the minimum number of new jobs and amount of capital investment required for that credit.

In addition, the bill is tie-barred to House Bill 4514. House Bill 4514 (S-3) would amend the Income Tax Act to retain the State earned income tax credit (EITC) at 10% of the Federal EITC for the 2009 tax year (instead of 20% as currently required), and phase in an increase in the State EITC to 20% of the Federal credit for tax years after 2012.

MCL 208.1111 et al.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce State General Fund tax revenue by approximately \$200.1 million in FY 2009-10 and \$323.5 million in FY 2010-11. The bill would have no effect on local revenue or expenditure.

The bill proposes numerous changes, each with a different impact. It is expected that the changes regarding tobacco taxes would lower revenue by \$5.4 million in FY 2009-10, while the changes in the brownfield credits would not have any impact within the next two fiscal years. Expansion of the entrepreneurial credit would reduce revenue by approximately \$3.0 million per year, while expansion of the small business credit would lower revenue by \$2.0 million in FY 2009-10 and \$8.4 million in FY 2010-11.

The phase-out of the surcharge would reduce General Fund revenue by an expected \$159.6 million in FY 2009-10 and \$301.3 million in FY 2010-11. Lowering the maximum surcharge in tax year 2009 would reduce revenue by an additional \$12.5 million in FY 2009-10.

The changes to the film and media infrastructure credit would lower revenue by approximately \$1.7 million in FY 2009-10 and \$2.0 million in FY 2010-11, while expanding the media production credit to include commercials unrelated to qualified productions would reduce revenue by \$9.4 million in FY 2009-10 and \$15.0 million in FY 2010-11. The change in the credit rate and the compensation thresholds in the media production credit would increase General Fund revenue by \$13.4 million in FY 2010-11.

This fiscal analysis assumes that the tie-bars to other bills would be eliminated or, because two of the tie-barred bills would amend the same sections of the MBT Act statute altered by this bill, that the other bills would be amended to match the provisions in this bill.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.