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House Bill 5921 (Substitute H-2 as passed by the House)

Sponsor: Representative Ellen Cogen Lipton

House Committee: New Economy and Quality of Life

Senate Committee: Economic Development and Regulatory Reform

Date Completed: 6-16-10

CONTENT

The bill would create the "Small Business Investment Credit" under the Income Tax Act to allow a taxpayer to claim a credit equal to 25% of a "qualified investment" in a "qualified business", for tax years beginning after 2009 and ending before 2014. The bill would do all of the following:

- -- Require a taxpayer to receive a certificate from the Michigan Strategic Fund (MSF) to qualify for the credit.
- -- Prohibit the MSF board from certifying more than \$1.0 million in qualified investments in any one business.
- -- Limit a taxpayer to a credit of \$500,000 based on an investment in any one business and for investments in all qualified businesses in any one year.
- -- Require a credit to be taken in installments over two years.
- -- Limit to \$10.0 million the total amount of credits the MSF could certify in one year, but allow the difference to be carried forward to the next year if less than that amount were awarded in any year.
- -- Allow a credit that exceeded a taxpayer's liability to be carried forward for up to 15 years.
- -- Require the MSF board to develop an application and approval process for the credit.
- -- Prohibit the MSF board from approving a credit for a convicted felon, if the conviction would have a material impact on the taxpayer's ability to participate in a qualified investment.

"Qualified investment" would mean an investment of at least \$15,000 certified by the MSF that is made alongside of, or through, a seed venture capital or angel investor group that is registered with and approved by the MSF and is not in a business that employs or is owned by any member of the investor's family or with which the investor or any member of the investor's family has a preexisting fiduciary relationship.

"Qualified business" would mean a business that the MSF board certifies as in compliance with all of the following at the time of the investment:

- -- The business is a "seed or early stage business" as defined in the Michigan Early Stage Venture Investment Act.
- -- The business has or will have, as determined by the MSF board, its headquarters in Michigan, is domiciled in Michigan, and has a majority of its employees working in Michigan.

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- -- The business has a preinvestment valuation of less than \$10.0 million and has fewer than 100 full-time equivalent employees.
- -- The business has been in existence less than five years.
- -- The business is an economic base employer as determined by the MSF board.

The requirement that the business have been in existence for less than five years would not apply to a business in which the business activity is derived from research at an institution of higher education located in Michigan or an organization exempt from Federal taxation under Section 501(c)(3) of the Internal Revenue Code that is located in Michigan. For this purpose, a public or private college or university that awards a bachelor's degree or other degrees would be considered an institution of higher education.

(Under the Michigan Early Stage Venture Investment Act, "seed or early stage business" means a business that has not fully established commercial operations and may also be engaged in continued research and product development, or that is engaged in product, service, or technology development and initial manufacturing, marketing, or sales activities.)

Certification for Credit

Under the bill, for tax years beginning after December 31, 2009, and ending before January 1, 2014, a taxpayer that made a qualified investment in a qualified business during the tax year could claim a credit against the income tax equal to 25% of that investment.

To qualify for the credit, a taxpayer would have to request certification from the MSF within 60 days of making an investment, and could not claim the credit unless the MSF had issued a certificate to the taxpayer. The MSF board could not approve a credit for a taxpayer who had been convicted of a felony, if the board determined that the conviction would have a material impact on the taxpayer's ability to participate in a qualified investment.

A taxpayer would have to attach the certificate to the annual income tax return on which the credit was claimed. The certificate would have to specify all of the following:

- -- The total amount of investment made during the tax year by the taxpayer in each qualified business.
- -- The total amount of qualified investments made in each qualified business, if different from the previous amount.
- -- The total amount of the credit that the taxpayer was allowed to claim for the designated tax year.

Credit Limits

The MSF could not certify more than \$1.0 million in qualified investments in any one qualified business.

A taxpayer could not claim a credit of more than \$500,000 based on an investment in any one qualified business and could not claim a credit of more than \$500,000 for qualified investments in all qualified businesses in any one year. The taxpayer would have to take the credit in equal installments over two years, beginning with the tax year in which the certification was issued.

The total amount of credits that the MSF could certify per calendar year under the bill could not exceed \$10.0 million. If the MSF approved less than that amount in a year, it could carry forward the difference and certify additional credits in the following year.

If the amount of the credit allowed exceeded a taxpayer's tax liability for the tax year, the excess portion could not be refunded but could be carried forward to offset income tax liability in subsequent tax years for up to 15 years or until used up, whichever occurred first.

Application & Approval Process

The MSF board would have to develop an application and approval process in order to certify investments under the bill, and would have to adopt a program describing parameters and criteria to be used for approving investments. As part of adopting that program, the board could do any of the following:

- -- Apportion the annual aggregate credit to include set-asides by credit size and early stage and other business categories.
- -- Develop a method to define, register, and approve angel investor groups, seed capital firms, and venture capital firms.
- -- Determine and describe the conditions to be met, to be considered an investment alongside or through an approved angel group, seed capital firm, or venture capital firm.

Proposed MCL 206.278

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill would reduce General Fund revenue and could lower School Aid Fund revenue, as well. The reduction in revenue would average approximately \$10.0 million per year, but the amount could vary because the bill would allow unawarded credits to carry over into subsequent years. School Aid Fund revenue would be reduced only to the extent that taxpayers reduced withholding and/or quarterly payments in expectation of claiming the credit; otherwise, the bill would reduce General Fund revenue only.

It is unknown how many taxpayers or business would be affected by the bill. The bill would limit the credit for an investment in a single business to \$500,000, but also would limit the certified investments in a single business to \$1.0 million, which would generate a credit of only \$250,000 based on 25% of the maximum credit amount—suggesting that the \$500,000 limit on the credit would be largely irrelevant. Similarly, investments would have to be made in qualified businesses, and the bill would require these businesses to be an "economic base employer", a term that is not defined in the bill or elsewhere in statute.

The bill would increase the responsibilities of the Michigan Strategic Fund, which would be required to administer the proposed Small Business Investment Credit, including developing application and approval processes and certifying credits. Michigan Strategic Fund staff have indicated that these responsibilities could be absorbed by existing employees. The MSF budget for FY 2009-10 is appropriated in Public Act 128 of 2009. The line item for Job Creation Services supports most of the agency's staff for business development programs. This line is appropriated at \$16,301,900 and 127.0 FTEs in FY 2009-10; \$13,025,200 of the appropriation is General Fund/General Purpose revenue.

Fiscal Analyst: Elizabeth Pratt Maria Tyszkiewicz David Zin

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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.