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BILL



ANALYSIS

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House Bill 4101 (Substitute S-1 as passed by the Senate)

Sponsor: Representative Al Pscholka

House Committee: Appropriations

Senate Committee: Appropriations

Date Completed: 6-22-15

CONTENT

The bill would appropriate \$100.0 million to purchase tax vouchers issued under the Michigan Early Stage Investment Act of 2003, using \$76.2 million of General Fund/General Purpose revenue and \$23.8 million of revenue from the Merit Award Trust Fund. The bill would authorize the purchase of \$50.0 million of vouchers scheduled to be tendered during fiscal year (FY) 2014-15 and \$50.0 million of vouchers scheduled to be tendered during FY 2015-16.

BACKGROUND

The Michigan Early Stage Venture Investment Act was enacted in 2003 in order to, as the legislation stated, "promote the economic health" of Michigan by "assisting in the creation of new jobs, new businesses, and new industries". Venture capital is a term that describes money invested in startup firms and small businesses that are perceived to have long-term growth potential but do not have access, or sufficient access, to capital markets. Venture capital investments are often regarded as risky but have the potential to generate above-average returns, at least over a long period of time. As a result, such investments are made only by firms and individuals who have the resources to weather substantial losses or can afford to wait sometimes decades for a return on their money.

Access to capital also can affect location decisions and it is not uncommon for firms that would be likely to attract the attention of venture capital investors to relocate to places where such capital is more readily available. By increasing the amount of venture capital available to Michigan businesses, the Michigan Early Stage Venture Investment Act intended not only to expand Michigan's economy but also to prevent the relocation of promising startup companies already located in the State.

However, in 2003 the State faced serious budgetary constraints because of the weak recovery following the 2001 recession, making it difficult to find funding for a new program that would require significant State revenue. As a result, the Michigan Early Stage Venture Investment Act was designed to commit future State revenue, through the use of tax incentives that would be redeemed in future years when the economy (and presumably State revenue) would be better, to guarantee loans from financial institutions for capital to invest in venture funds in the near term. Further, the operations of the program were structured to require the involvement of outside venture capital funds, thus allowing the State's near-term investments to leverage additional venture capital from private investors.

While the Act authorizes up to \$600.0 million in tax vouchers to guarantee these loans, only \$450.0 million in tax vouchers has been issued to date. The vouchers may be claimed against

withholding requirements of the Individual Income Tax. The agreements with the lenders specify dates for when repayments must be made against the loans and the first two repayments scheduled total \$50.0 million in FY 2014-15 and \$50.0 million in FY 2015-16.

Under current law, the tax vouchers may be sold in order to satisfy required loan payments. If the vouchers are sold to taxpayers, they are typically sold at a discount, so that the taxpayer is able to receive the face value of the voucher, in the form of a reduced cash liability, but the seller receives less than the face value of the voucher. Common discount rates average 10.0%, so a taxpayer would purchase a \$50.0 million voucher for \$45.0 million, but State revenue would still be reduced by \$50.0 million when the taxpayer applied the voucher against a tax payment. Certain reserve funds were created under the venture capital agreements to reserve capital to make up any shortfall created by the discounting of the vouchers.

FISCAL IMPACT

The fiscal impact of the bill would depend on what tax liabilities the vouchers would otherwise be applied to if the bill were not enacted. If \$50.0 million of vouchers were applied to Michigan Business Tax liabilities, the vouchers would reduce State General Fund revenue by \$50.0 million. The consensus revenue estimates assume the vouchers would be applied against individual income tax withholding, such that \$50.0 million in vouchers would reduce General Fund revenue by \$38.1 million and School Aid Fund revenue by \$11.9 million.

While the bill appropriates \$100.0 million of FY 2014-15 revenue to purchase the tax vouchers, because the impact of the vouchers is already included in current estimates of General Fund and School Aid Fund revenue for FY 2014-15 and FY 2015-16, the net impact of the bill reallocates the impact across different funds and different fiscal years. As a result, assuming the vouchers would otherwise be applied to individual income tax withholding payments, the bill would reduce General Fund revenue by \$38.1 million in FY 2014-15 and increase General Fund revenue by \$38.1 million in FY 2015-16, reduce Merit Award Trust Fund revenue by \$23.8 million in FY 2014-15, and increase School Aid Fund revenue by \$11.9 million in both FY 2014-15 and FY 2015-16. The bill would satisfy loan repayments required during FY 2014-15 and FY 2015-16. Also, if the vouchers were purchased for the full face value, a portion of the reserves held to cover discounting could be applied to the loan principal, lowering both interest costs associated with the loans and the number of vouchers that would need to be redeemed in the future without having any impact on State revenue over the two fiscal years.

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