Legislative Analysis

RESEARCH AND DEVELOPMENT TAX CREDIT

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House Bill 4368 (H-1) as passed by the Senate
Sponsor: Rep. Greg VanWoerkom

House Bill 5099 (H-1) as passed by the Senate
Sponsor: Rep. Rachel Hood

House Bill 5100 (S-1) as passed by the Senate
Sponsor: Rep. Jasper Martus

House Bill 5101 (S-1) as passed by the Senate
Sponsor: Rep. Julie M. Rogers

House Bill 5102 (H-1) as passed by the Senate
Sponsor: Rep. Ranjeev Puri

House Committee (HB 4368): Tax Policy [Discharged]
House Committee (HBs 5099 to 5102): Economic Development and Small Business
Senate Committee: Committee of the Whole

Complete to 4-18-24

SUMMARY:

House Bills 4368 and 5099 to 5102 would create a state-level tax credit to foster research and development (R&D) in Michigan. House Bills 5100 and 5101 would create a corporate income tax credit and a withholding tax credit, respectively, under the Income Tax Act, and House Bills 4368, 5102, and 5099 are companion bills that would define terms and create reporting requirements for the program.

__House Bill 4368__ would add a new section to the Income Tax Act to define the following terms with respect to a research and development tax credit:

> For purposes of the R&D tax credit provided by House Bill 5100, ***authorized business*** would mean an entity subject to the corporate income tax that has increased its qualifying research and development expenses. For purposes of the credit provided by 5101, ***authorized business*** would mean a flow-through entity that is subject to tax withholding requirements under the Income Tax Act, has increased its qualifying research and development expenses, and is not subject to the Michigan Business Tax Act for that year.
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> ***Base amount*** would mean the average annual amount of qualifying research and development expenses during the three calendar years immediately preceding the calendar year ending with or within the tax year for which a research and development tax credit is claimed. An authorized business with no prior qualifying R&D expenses would have a base amount of zero, and if qualifying R&D expenses were incurred in only one or two of those three years, then the average annual amount would be based on the number of calendar years in which qualifying R&D expenses were incurred.

Qualifying research and development expenses would mean qualified research expenses (QREs), as that term is defined under federal law, for research conducted in Michigan.[1] Generally, it would mean spending for technological research, including employee wages, contract expenses, and supply costs.

Research university would mean a public university in Michigan or an independent nonprofit college or university in Michigan.

Proposed MCL 206.282

House Bill 5100 would amend the Income Tax Act to provide a credit against the corporate income tax for authorized businesses for qualified research and development expenses incurred in Michigan. The credits would be available beginning January 1, 2024, and would be claimed after all other tax credits under the corporate income tax.

Credit amount
All authorized businesses would be eligible for a credit of an amount equal to 3% of their qualifying R&D expenses incurred during a calendar year up to the base amount. A business with 250 or more employees that incurs expenses in excess of the base amount would be eligible for a credit of 10% of the expenses above the base amount, up to a total credit maximum of $2.0 million, and a business with fewer than 250 employees would be eligible for a credit of 15% of its expenses above the base amount, up to a total credit maximum of $250,000.

An authorized business could claim an additional credit for 5% of its qualified R&D expenses over the base amount if those expenses are incurred in collaboration with a Michigan research university pursuant to a written agreement between the business and the university. The additional credit would be capped at $200,000 per tax year for each authorized business.

Claims
To receive the credit, an authorized business would have to submit a tentative claim to Treasury by the March 15 following the calendar year ending with or within the tax year for which it intends to claim a credit. The tentative claim would have to include whether the business is claiming a 10% credit or a 15% credit (as applicable depending on the number of employees), the amount of qualified research and development expenses for which the credit is being claimed, and if an additional credit is being claimed for collaboration with a research university.

Treasury could not approve more than $100.0 in tax credits under the R&D tax program in a single calendar year, and $25.0 million would be reserved for businesses with fewer than 250 employees. If the total amount of credits claimed exceeds the $100.0 million cap, Treasury would prorate the credits as follows:

If the total amount of credits claimed against the corporate income tax or the withholding tax (as provided under House Bill 5101) by authorized businesses with fewer than 250 employees is $25.0 million or less, the credits claimed by those businesses would not be reduced, but the

[1] For a full description of qualified research expenses, see: https://www.irs.gov/businesses/audit-techniques-guide-credit-for-increasing-research-activities-ie-research-tax-credit-irc-ss-41-qualified-research-expenses.

credits claimed by businesses with 250 or more employees would be proportionally reduced to reflect each business's share of the remaining available credits.

If the total amount of credits claimed by businesses with fewer than 250 employees is more than $25.0 million, then all credits under the program would be prorated so that each claimant's allowed credit is proportional to its share of $25.0 million or $75.0 million, as applicable depending on the number of employees at the business. However, if claims from businesses with fewer than 250 employees comprise over 25% of the total amount of credits claimed, then the amount of credits claimed by each business, regardless of its size, would be proportionally reduced to reflect each business's share of the $100.0 million.

<u>Credit administration</u>
Treasury would review all tentative claims and could require an authorized business claiming an additional credit for collaborating with a research university to provide a copy of the required written agreement in order to receive the additional credit.

If the total amount of submitted claims exceeds $100.0 million for a calendar year, Treasury would have to publish a notice on its website to notify businesses of the prorated adjustments to the claims for that year.

An authorized business would have to file a claim for the credit with its annual tax return as directed by Treasury. Credits would not be transferable, but if the amount of the allowed credit exceeded the tax liability of an applicant for the tax year, that portion of the credit that exceeded the tax liability would be refunded.

Proposed MCL 206. 677

<u>House Bill 5101</u> would amend the Income Tax Act to provide a credit against withholding taxes for flow-through entities that are authorized businesses for qualified research and development expenses incurred in Michigan. The credits would be available beginning January 1, 2024, and would be claimed after all other tax credits under the Income Tax Act. A member of a flow-through entity would not be eligible to claim the credit.

<u>Credit amount</u>
All authorized businesses would be eligible for a credit of an amount equal to 3% of their qualifying R&D expenses incurred during a calendar year up to the base amount. A business with 250 or more employees that incurs expenses in excess of the base amount would be eligible for a credit of 10% of the expenses above the base amount, up to a total credit maximum of $2.0 million, and a business with fewer than 250 employees would be eligible for a credit of 15% of its expenses above the base amount, up to a total credit maximum of $250,000.

A business could claim an additional credit for 5% of its qualified R&D expenses over the base amount if those expenses are incurred in collaboration with a Michigan research university pursuant to a written agreement between the business and the university, which would be capped at $200,000 per tax year for each business.

<u>Claims</u>
To receive the credit, an authorized business would have to submit a tentative claim to Treasury by the March 15 following the calendar year ending with or within the tax year for which it

intends to claim a credit. The tentative claim would have to include whether the business is claiming a 10% credit or a 15% credit (as applicable), the amount of qualified research and development expenses for which the credit is being claimed, and if an additional credit is being claimed for collaboration with a research university.

The amount of total credits would be subject to the same $100.0 million annual cap and proration requirements as described for House Bill 5100.

Credit administration

Treasury would review all tentative claims and could require an authorized business that is claiming an additional credit for collaborating with a research university to provide a copy of the required written agreement in order to receive the additional credit.

If the total amount of submitted claims exceeds $100.0 million for a calendar year, Treasury would have to publish a notice on its website to notify businesses of the prorated adjustments to the claims for that year.

An authorized business would have to file a claim for the credit with their annual tax return as directed by Treasury. Credits would not be transferable, but if the amount of the allowed credit exceeded the tax liability of an applicant for the tax year, that portion of the credit that exceeded the tax liability would be refunded.

Proposed MCL 206.717

House Bill 5102 would amend the Income Tax Act to require the Michigan Department of Treasury to submit a report on the R&D tax credit program in collaboration with the Michigan Strategic Fund (MSF).

By July 1 of each year, Treasury would have to submit a report to each member of the legislature, the governor, the clerk of the House, the secretary of the Senate, and the Senate and House fiscal agencies that includes the following:

- A brief assessment of the overall effectiveness of the research and development tax credits. (An incentive evaluation prepared in compliance with the Economic Development Incentive Evaluation Act would satisfy this requirement.)
- The number of authorized businesses that filed tentative claims for a credit for the immediately preceding calendar year.
- The name of each authorized business submitting a claim for a credit and the amount of the credit allowed for that business for the immediately preceding calendar year.
- The name of each authorized business claiming an additional credit for collaboration with a Michigan research university and the amount of the credit for the immediately preceding calendar year.

The bill would also authorize the MSF board of directors to delegate any of its actions under Chapter 17 of the Income Tax Act to authorized MSF employees, officers, and agents, including employees of the Michigan Economic Development Corporation (MEDC).

Proposed MCL 206.718

House Bill 5099 would amend the Michigan Strategic Fund Act to require the MSF to cooperate with Treasury and assist in preparing the report required by House Bill 5102.

MCL 125.2009

BACKGROUND:

An R&D tax credit is available at the federal level under section 41 of the Internal Revenue Code.[2] As of June 2023, 36 states reportedly offer an R&D tax credit to offset state tax liability.[3]

Michigan previously offered a research and development tax credit under the Michigan Business Tax (MBT) Act, but the credit was eliminated when the MBT was repealed in 2011.

BRIEF DISCUSSION:

Supporters of the bills note that Michigan is one of only 14 states, and the only state in the Midwest, without a research and development tax credit. Because some companies will only consider states with an R&D tax credit when deciding where to invest, Michigan's lack of such a credit hinders its competitiveness and its ability to attract global talent. Supporters argue that instituting a research and development tax credit in Michigan would allow the state to be a frontrunner in innovation, incentivize more companies to invest in the state, and attract employees looking for high-paying jobs in these industries. Additionally, administering the R&D credit through the tax code will ensure that all businesses innovating in Michigan can receive the benefits of the tax credit program.

While opponents of the bills generally support instituting a state-level R&D tax credit, they believe that the $100 million annual cap proposed by the bills is too low to incentivize transformational investments. Concerns were also raised with initial versions of the legislation, which allowed the Michigan Strategic Fund to administer the program rather than the Department of Treasury, as critics of this approach argued that it was too complicated, narrow, and unpredictable for businesses.

FISCAL IMPACT:

As written, the bills would be expected to reduce state revenue by approximately $100 million annually for tax years beginning after January 1, 2024.

Although the bills state that the Department of Treasury may not authorize more than $100 million of income tax credits in any single calendar year, it is possible that the actual revenue impact of the credits could be more than or less than $100 million in a given year depending on when the credits are actually claimed.

Any revenue loss would come from the general fund.

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[2] See: [USCODE-2021-title26-subtitleA-chap1-subchapA-partIV-subpartD-sec41.pdf (govinfo.gov)]
[3] https://www.kbkg.com/research-tax-credits/research-development-tax-credit-state-benefits.

The bills would increase costs to the Michigan Strategic Fund (MSF) and the Department of Treasury by an indeterminate amount for additional administrative duties for the research and development tax credit program under the bills' provisions. In addition, House Bill 5102 would require the Department of Treasury and the MSF to report specific information annually to the legislature, the governor, and other entities on each research and development tax credit claim that was filed and the overall effectiveness of the tax credit program.

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