This revised analysis replaces the analysis dated 9-24-02.

House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

TAX INCENTIVES FOR PHARMACEUTICAL COMPANIES

House Bill 5726 (Substitute H-4)
Sponsor: Rep. Mary Ann Middaugh

House Bill 6077 (Substitute H-1)
Sponsor: Rep. Gary Woronchak

Senate Bill 1315 (Substitute H-2)
Sponsor: Sen. Don Koivisto

Revised First Analysis (10-18-02)
Committee: Energy and Technology

THE APPARENT PROBLEM:

In July 2002 Pfizer Inc. and Pharmacia Corporation announced that the two pharmaceutical companies had reached agreement on a plan for Pfizer to acquire Pharmacia. Although Pfizer is based in New York City and Pharmacia is based in New Jersey, both companies have operations in Michigan—Pfizer in Ann Arbor and Pharmacia in Kalamazoo, Portland, and Richland. The plan is subject to Federal Trade Commission approval, but many experts expect the deal to go through, since there is little overlap in the companies' product lines and thus little basis for antitrust concerns. As might be expected, the prospect of a merger has fueled speculation about the fate of Pharmacia's research and development operations and employees in southwestern Michigan. In a July 15, 2002 press release, Pfizer announced that it hopes that the consolidation will result in "peak year synergies", i.e., cost savings, of about $2.5 billion by 2005. A July 21, 2002 article in the *Kalamazoo Gazette* stated that officials of both companies "expect the majority of cost savings to come from Pharmacia" and that analysts "expect Pharmacia employees at the company's offices in New Jersey to be most affected by the transition". Still, such expectations provide no guarantees, and business leaders in southwestern Michigan would prefer to take a proactive approach to ensure that Pfizer builds on Pharmacia's strong ties to the area rather than risking the loss of several thousand jobs and the financial costs that such massive job cuts would involve.

According to committee testimony, one of the biggest drawbacks to doing business in Michigan is the lack of research and development tax incentives. Business leaders have suggested that this places the state at a significant competitive disadvantage with respect to the 22 states that allegedly do offer R&D tax incentives, when it tries to attract new companies and retain companies currently operating here. Local government officials and business leaders are supporting legislation that would give certain tax breaks to Pfizer, as well as any other pharmaceutical company that met the bill's specifications, and would authorize local governments to give Pfizer (and potentially other pharmaceutical companies) other tax breaks.

THE CONTENT OF THE BILLS:

House Bills 5726 and 6077 and Senate Bill 1315 would create a series of tax incentives targeted at pharmaceutical companies that employ at least 8,500 persons in the state within a 100 mile radius, at least 5,000 of whom are engaged in the research and development of pharmaceuticals. House Bill 5726 would amend the General Property Tax Act to authorize local governments to exempt such companies from taxes on new personal property. House Bill 6077 would amend the Michigan Economic Growth Authority Act to allow such companies to apply for and receive Single Business Tax credits. Senate Bill 1315 would amend the Michigan Renaissance Zone Act to authorize the Michigan Strategic Fund to create a pharmaceutical renaissance zone, and facilities of eligible pharmaceutical companies located within the zone would qualify for tax exemptions, credits, and deductions conferred by renaissance zone status. Specifically the bills would do the following:

House Bill 6077 would amend the Michigan Economic Growth Authority Act (MCL 207.803, 207.804, and 207.808) to allow pharmaceutical companies that meet certain conditions (e.g., employ 8,500 persons in the state within a 100 mile radius, 5,000 of whom work in pharmaceutical R&D) to apply for specific Single Business Tax (SBT) credits. The act allows the Michigan Economic Growth Authority (MEGA) to grant several credits against the SBT to businesses that agree to create and retain jobs in the state if MEGA determines that a business meets requirements set forth in the act. In general, firms expanding within the state or locating to the state must create and retain 75 qualified new jobs in order to receive the credit. If a firm qualifies, MEGA determines the amount and duration (up to 20 years) of the credits and enters into a written agreement with the business specifying the details and conditions of the credits. Businesses that agree to retain at least 500 jobs and to make major capital investments in the state—$250 million for a business located in the state on the date of its application, or $500 million for a business that relocates production of a product to the state after the date of its application—can also qualify for the credits, whether or not they create any new jobs.

"Eligible pharmaceutical company". To be eligible to apply for the credits, a pharmaceutical company would have to meet four criteria. First, the company would have to be engaged primarily in the manufacturing, research and development, and sale of pharmaceuticals. Second, the company could have no less than 8,500 employees located in the state, all of whom would have to be located within a 100 mile radius of one another. Third, of the 8,500 or more employees located in the state, at least 5,000 would have to be engaged primarily in the research and development of pharmaceuticals. Fourth, the company would have to enter a written agreement with the Michigan Economic Growth Authority (MEGA) within 18 months of the bill's effective date.

Written agreement and tax credit. MEGA and a pharmaceutical company that met these eligibility requirements could enter into a written agreement allowing the company specific SBT credits in a specific amount and for a specific duration. The bill, in conjunction with current law, would provide three paths by which a pharmaceutical company could apply for and receive the credits. First, a pharmaceutical company that expanded operations or located a facility in the state could create a minimum of five qualified new jobs at the facility within the first year of expanding or locating in the state and would continue to get the credit for each tax year that it retained those jobs. (A company creating new jobs would have to meet several other conditions specified under current law.) Second, like any eligible business under current law, a pharmaceutical company that was located in the state on the date of its application could agree to make a new capital investment of $250 million in the state and to retain 500 jobs on an ongoing basis. Third, like any eligible business under current law, a pharmaceutical company could agree to relocate production of a product to the state after the date of its application, to make capital investment of $500 million, and to retain 500 jobs on an ongoing basis.

Transfer of MEGA to the Michigan Strategic Fund. The bill would also amend the act to reflect the transfer of MEGA from the Michigan Jobs Commission to the Michigan Strategic Fund, as accomplished by Executive Order 1999-1. (The order transferred MEGA "and all of its statutory authority, powers, duties, functions and responsibilities, including the functions of budgeting, procurement, personnel and management related functions" to the Michigan Strategic Fund.)

Eliminate obsolete reference to International Tradeport Development Authority Act. The bill would eliminate an obsolete reference to the International Tradeport Development Authority Act, which was repealed by Public Act 90 of 2002.

Senate Bill 1315 would amend the Michigan Renaissance Zone Act (MCL 125.2688a) to allow the board of the Michigan Strategic Fund to designate a renaissance zone as a "pharmaceutical renaissance zone". Currently, the act allows the strategic fund to designate up to five renaissance zones. The pharmaceutical renaissance zone would be created to promote and increase the research, development, and manufacturing of pharmaceutical products of an eligible pharmaceutical company. The definition of "eligible pharmaceutical company" would be similar to the definition under House Bill 6077 (see above), except that Senate Bill 1315 would not require that the pharmaceutical company had already entered into a written agreement with MEGA. The pharmaceutical renaissance zone would have to be designated not later than 18 months after the bill's effective date, and any city, village, or township in which the zone was to be located would have to consent to the zone's creation.

Businesses that are located and conduct business in renaissance zones are eligible for certain tax exemptions from, deductions from, and credits for the

SBT, city and state income tax and city utility users tax act. Property located in a renaissance zone is also eligible for certain tax exemptions.

(As it was introduced and passed by the Senate, Senate Bill 1315 would have allowed the strategic fund to designate a renaissance zone as an "alternative energy zone". Since that time the legislature has accomplished this by enacting Public Act 512 of 2002.)

House Bill 5726 would amend the General Property Tax Act (MCL 211.9f) to permit the governing body of a local tax collecting unit to exempt from collection of taxes under the act all "new personal property" owned or leased by eligible pharmaceutical companies located in the local tax collecting unit. The governing body of the unit would have to adopt a resolution exempting the pharmaceutical companies from personal property taxes not later than 18 months after the bill's effective date. "New personal property", as defined in the bill, would refer to personal property that was placed in a local tax collecting unit after the governing body of the local tax collecting unit adopted such a resolution, as long as the property was not previously subject to tax under the act.

Procedures. The clerk of the local tax collecting unit would have to notify in writing the assessor of the local tax collecting unit in which the companies were located and the legislative body of each taxing unit that levied ad valorem property taxes in the unit. Before acting on the resolution, the governing body of the local tax collecting unit would have to give the assessor and a representative of the affected taxing units an opportunity for a hearing. The exemption would be effective on the December 31 immediately following the adoption of the resolution and would continue in effect for a period specified in the resolution. A copy of the resolution would have to be filed with the State Tax Commission, and the commission would have to approve or disapprove of the resolution not more than 60 days after receiving it. The state treasurer and the president of the Michigan Strategic Fund would have to advise the commission as to whether the new personal property exemption was necessary to reduce unemployment, promote economic growth, and increase capital investment in the state.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, if MEGA offered an SBT credit to an eligible pharmaceutical company as allowed by House Bill 6077, the bill would reduce state general fund/general purpose revenues. The specific amount would depend on the amount and duration of the credit, as determined by MEGA. (9-24-02)

The HFA reports that Senate Bill 1315 would have no fiscal impact on the state or on local units of government. (9-24-02)

ARGUMENTS:

For:

The bills would create tax incentives for Pfizer, as well as any other pharmaceutical company meeting the bills' eligibility requirements, to keep Pharmacia's research and development operations in Michigan going. Twenty-two other states offer such research and development incentives, and without offering a competitive package, the Kalamazoo area and the state could risk losing a major employer and the economic benefits that come with it. While some people may be confident that Pfizer's projected buyout of Pharmacia will not result in severe job losses for Pharmacia's Michigan employees, and some experts believe that layoffs of high-skilled workers could invigorage smaller biotech companies, business leaders and government officials in southwestern Michigan, particularly Kalamazoo, prefer not to take any unnecessary chances. Pharmacia is Kalamazoo County's biggest employer, and as Pfizer officials consider how to most effectively restructure the corporate organization, they are certain to consider the relative costs and benefits of continuing Pharmacia's research and development operations in the Kalamazoo area. Southwest Michigan First, a local economic development corporation, has estimated that 2,000 or more high-skilled R&D jobs could be in jeopardy. A potential loss of so many jobs—good jobs—is clearly good reason for concern. But local government officials and business leaders also warn that Pfizer's exodus would also represent a significant loss for the Life Sciences Corridor, which is an integral component of the state's larger economic diversification strategy.

Because Kalamazoo area leaders are sensitive to Pfizer's need for flexibility, the legislation has been drafted to protect at least 5,000 R & D jobs in the state, within a 100-mile radius. This would allow Pfizer to keep its Ann Arbor operations, where approximately 3,000 workers work in R&D, and its Kalamazoo area operations, where there are over 2,000 R&D workers, going. While nothing in the legislation would preclude Pfizer from creating 2,000 new R&D jobs in the Ann Arbor and shutting down its Kalamazoo area operations, Kalamazoo area leaders are confident that they can offer an attractive package to any potential employer, let alone one with facilities already in place. The legislation would help Kalamazoo area leaders and the state remind Pfizer that Michigan is an attractive place to do business.

Against:

In the press release announcing the planned buyout, Pfizer boasted: "Already the leading pharmaceutical company in the United States and Canada, Pfizer with Pharmacia will move from fourth to first in Europe; from third to first in Japan; and from fifth to first in Latin America in pharmaceutical sales." Pfizer also observed that "[t]he companies' combined R&D budget for 2002 exceeds $7 billion, making it by far the largest privately funded biomedical research organization in the world." Whether or not the FTC raises any antitrust concerns, the new and improved Pfizer would certainly not be lacking funds for research and development. While no one wants Pfizer to leave the state, clearly the company can afford to pay its fair share in taxes.

In a related concern, some people believe that pharmaceutical companies huge profits would suggest that they can afford to lower drug prices. In the House Energy and Technology Committee an amendment was offered to tie-bar House Bill 5726 to House Bill 5930, which would create the Michigan Prescription Drug Fair Pricing Act.

Response:

Whether or not Pfizer can afford to pay the amount of taxes that it would have to pay without the breaks is beside the point. The state has a vital interest in retaining jobs that may be lost. With 22 other states offering R&D tax incentives, Michigan cannot afford to take the risk of losing Pfizer jobs.

Any legislation concerning prescription drug prices involves complex issues that should be considered separately. The FTC is expected to approve Pfizer's buyout of Pharmacia on November 15, 2002, and without the tax incentives in hand, Michigan leaders will be unprepared to talk specifics with Pfizer.

POSITIONS:

The City of Kalamazoo supports the bills. (9-24-02)

The Kalamazoo Region Chamber of Commerce supports the bills. (9-24-02)

Southwestern Michigan First supports the bills. (9-24-02)

Analyst: J. Caver

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.