

Legislative Analysis



REMOVE FEDERAL GRANTS FROM SBT BASE

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Senate Bill 1116 as passed by the Senate

Sponsor: Sen. Gerald Van Woerkom

House Committee: Commerce

Senate Committee: Finance

First Analysis (5-18-04)

BRIEF SUMMARY: The bill would remove federal grants received by businesses from the tax base of the Single Business Tax.

FISCAL IMPACT: In FY 2001-2002, small businesses in Michigan received approximately \$27 million in Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) grants from the Federal Government. In addition, \$1 million in matching grants is planned to be issued through the Michigan Technology Tri-Corridor SBIR Emerging Business Fund. Given that this bill would allow businesses to deduct this grant revenue from their single business tax base, it is estimated the bill would reduce single business tax revenue by less than \$0.5 million. This loss in revenue would affect General Fund/General Purpose revenue. There would not be any direct impact on local governments.

THE APPARENT PROBLEM:

Currently, about 75 percent of U.S. patents are based on publicly funded research, according to the Small Business Association of Michigan (SBAM). Federal grants such as the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs provide funding to cutting-edge small businesses to research and develop breakthrough technology. Many of the technological innovations implemented by businesses receiving SBIR and STTR grants are the result of research conducted at the nation's large public universities. According to the SBAM, Michigan ranks 18th in the nation when it comes to receiving SBIR and STTR grants for small business new product development, despite the fact that several of the country's top research institutions are located in Michigan.

Some people believe that Michigan's single business tax (SBT) is at least partly responsible for the choice of new high-tech businesses not to locate in the state. Many of these small businesses apparently receive most of their start-up funding from SBIR and STTR grants, which are considered part of a business's tax base when its SBT liability is calculated. It has been suggested that the income from these grants should not be subject to the SBT.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax (SBT) Act to allow SBT taxpayers to deduct from their tax base income received from either grants from the Michigan Technology Tri-Corridor SBIR Emerging Businesses Fund administered by the Michigan Economic Development Corporation; or SBIR grants and STTR programs established under the Federal Small Business Innovation Development Act of 1982 and reauthorized under the Small Business Research and Development Enhancement Act and the Small Business Reauthorization Act of 2000.

MCL 208.9

HOUSE COMMITTEE ACTION:

The House Committee on Commerce reported the bill without amendment. It remains in the same form that it passed the Senate. Information in this analysis is derived from the Senate Fiscal Agency's analysis of that version dated 4-8-04.

BACKGROUND INFORMATION:

According to the Michigan Economic Development Corporation, through the 2004 Michigan Technology Tri-Corridor program, \$1 million has been allocated for the Michigan Technology Tri-Corridor SBIR Emerging Business Fund to foster growth in the automotive, life sciences, and homeland security industries. The purposes of this fund are to increase the numbers and competitiveness of Michigan SBIR proposals by providing support to Michigan businesses, and to increase the success of Michigan businesses moving from Phase I, start-up, to Phase II, when research and development (R&D) work is performed and the developer evaluates the potential for commercialization.

According to the U.S. Small Business Administration (SBA), the SBIR is a federal program that encourages small businesses to explore their technological potential and provide the incentive to profit from its commercialization. Each year, certain federal departments and agencies are required to reserve a portion of their R&D funds for awards to small businesses that submit proposals to the program. Qualified businesses may receive funding to support the exploration of the technical merit or feasibility of an idea or technology and to evaluate its commercial potential. To be eligible, a business must be American-owned, independently operated, and for profit; employ the principal researcher; and have not more than 500 employees.

The SBA describes the STTR as a competitive program that reserves a specific percentage of federal R&D funding for awards to small businesses and nonprofit research institution partners. The STTR program is intended to combine the strengths of both entities by introducing entrepreneurial skills to high-tech research efforts. The technologies and products are transferred from the laboratory to the marketplace.

ARGUMENTS:

For:

Taxing SBIR and STTR grants serves as a barrier to innovation in this state, because the SBT is a disincentive for Michigan small businesses to pursue the cutting-edge technologies the grants are intended to finance. By allowing small technology companies to deduct from their SBT base income received from SBIR and STTR grants and the Michigan Technology Tri-Corridor SBIR matching grants, the bill would help make Michigan more attractive to these businesses, and would encourage firms already in the state to pursue the Federal funding. The small businesses receiving the grants benefit from third-party investment and profit from commercialization, or the manufacturer and sale of new products. The state, in turn, benefits from the creation of high-paying jobs and economic development. The SBIR and STTR grants rarely cover operating expenses for the companies that receive them, which are often businesses that have difficulty attracting other outside financing. Thus, even a small reduction in the grant amount could affect the firms' ability to stay in business, or their decision to remain in or move to Michigan.

Against:

The SBT's share of the SBIR and STTR grants amounts to only about 2 percent of the grants. This is hardly onerous. It does not seem likely that this amount would be enough to discourage a business from locating in Michigan. Moreover, since the SBT is a business activity tax, it is not inappropriate for these grants to be part of the base. This bill contributes to the further erosion of the base of the SBT, which is due to expire in 2009.

POSITIONS:

The Department of Treasury has indicated opposition to the bill. (5-14-04)

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■ 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.