

Legislative Analysis



INCENTIVES FOR "START-UP" BUSINESSES

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House Bill 6025 as enrolled
Public Act 252 of 2004
Sponsor: Rep. Matt Milosch

House Bill 6026 as enrolled
Public Act 251 of 2004
Sponsor: Rep. Scott Hummel
House Committee: Tax Policy
Senate Committee: Economic Development, Small Business and Regulatory Reform

Second Analysis (12-29-04)

BRIEF SUMMARY: The bills would provide certain start-up businesses with exemptions from taxation under the General Property Tax Act and the Obsolete Property Rehabilitation Act

FISCAL IMPACT: The fiscal impact of House Bills 6025 and 6026 would depend on the number of qualified start-up businesses and the degree to which local units approve exemptions.

THE APPARENT PROBLEM:

During the most recent economic downturn and the subsequent (and protracted) “jobless recovery” the state has lost a significant number of jobs, particularly in the manufacturing sector. By some estimates, the state has lost 185,000 manufacturing jobs since 1999. For some years the state has tried to transform itself from a traditional “rust-belt” state dominated by the manufacturing sector into a national leader the development of new and emerging technologies. The state has attempted this through numerous programs, such as the development of the Life Sciences Corridor and the Technology Tri-corridor, and the creation of local “smart zones.” Research suggests that small businesses are responsible for much of the job growth in recent years. Moreover, some people believe the development of small, high-tech firms could be a practical way to stem the flow of job losses and lead the way to an economic recovery.

Tax incentives have been proposed as one means of spurring the development of small, high-tech firms. Earlier this session, as part of a larger package of bills aimed at fostering the development of start-up, high-tech businesses, the legislature passed bills that would have exempted such businesses from taxation under the General Property Tax Act and the Obsolete Property Rehabilitation Act. Those bills, along with all but one bill in the package, were vetoed by the governor in May. Legislation has been introduced to address the governor’s criticisms.

THE CONTENT OF THE BILLS:

The bills would allow local units of government to provide exemptions from property taxes and from the obsolete properties specific tax for businesses that already qualify for the single business tax "start-up" credit. A business could not receive exemptions in more than five tax years (although exemptions could be received in nonconsecutive years), and a new application would have to be submitted each year.

The process would be the same for each kind of exemption. Application for an exemption would be made to the local tax collecting unit, which would have to afford the local assessor and representatives of other affected taxing units the opportunity for a hearing on the exemption. The application would have to include an affidavit stating that the business qualified for and received the single business tax "start-up" credit and including the applicant's SBT tax return. The business would also have to authorize the Department of Treasury to release information in that return relevant to the SBT start-up credit. The affidavit would have to be submitted on or before May 1 in each tax year the exemption was sought.

To approve an exemption, the local governing body would have to approve a resolution on or before its last meeting in May each tax year. The exemption would not apply to special assessments, ad valorem property taxes levied specifically for the payment of principal and interest on bonds, school enhancement millages, and school building sinking funds.

If a business filed for an extension to file its SBT return, the business could claim the property tax credit after May 1, but only if the governing body of the local tax collecting unit had approved the exemption for all qualified start-up businesses that filed for an extension. The business would have to submit a copy of its application for an extension and the required affidavit to the December Board of Review.

If an exemption was erroneously granted, the tax roll would be corrected for the current tax year and the three previous tax years. If the property owner paid the corrected tax bill within 60 days after issuance of the corrected bill, there would be no penalty or interest on the additional tax.

House Bill 6025 would amend the General Property Tax Act (MCL 211.7hh) to exempt the real and personal property of a "qualified start up business."

House Bill 6026 would amend the Obsolete Property Rehabilitation Act (MCL 125.2790) to provide a rehabilitated facility owned by a qualified start-up business with an exemption from the obsolete properties specific tax.

[Under that act, a qualified local unit of government can establish an obsolete property rehabilitation district to provide tax abatements to commercial facilities and residential property undergoing rehabilitation. In lieu of the property tax levied under the General Property Tax Act, the act levies the obsolete properties tax, which is a specific tax based

on the taxable value of the facility before rehabilitation. The exemption is for the facility not the land and not, generally speaking, for personal property. The exemption does not apply to local and state school operating taxes.]

BACKGROUND INFORMATION:

A “*qualified start-up business*” is defined in the Single Business Tax Act to mean a business that (1) has fewer than 25 full-time equivalent employees; (2) has sales of less than \$1 million in the tax year for which the credit is claimed; (3) has research and development expenses (as defined under the federal Internal Revenue Code) that constitute at least 15 percent of its expenses in the tax year for which the credit is claimed; (4) is not publicly traded; and (5) was in or would have been in the first two years of contribution liability under the Michigan Employment Security Act, in the immediately preceding seven years. This term was added to the Single Business Tax Act by Public Act 126 of 2004 (House Bill 5331). That act creates an SBT credit for this category of businesses.

ARGUMENTS:

For:

Some people believe that the development and growth of small, high-tech firms is a key to the state’s economic well-being. During the most recent economic downturn, the state lost thousands of well-paying manufacturing jobs. These losses are likely to be permanent. Where the state has seen increased employment is in the service sector. However, these jobs typically do not pay as well as the manufacturing jobs they replaced. As a result, the state must look to new industries, such as, biotechnology, nanotechnology and, of course, advanced automotive technology. Indeed, a recent report by the Michigan Economic Development Corporation states, “[e]ven with the recent softening of the global-economy, companies continue to have difficulty filling these high-paying technology jobs in our state. If Michigan is to sustain a positive economic future, economic development strategies and policies must be refined and directed toward investments that retain, create, and attract more and more of these businesses, jobs, and workers.”

A February 2004 article in the *Detroit Free Press* appropriately entitled, “Michigan’s Employment Crisis: Biotech firms could be cure for job losses”, puts it well. The article notes that, “[t]he evolution of the state’s biotech industry—still considered by many analysts to be in its infancy—could redefine the state’s labor environment.” However, the article questions whether state business and political leaders have the commitment necessary to support biotech growth. This package of bills demonstrates that commitment. The *Free Press* article also says, “[s]mall biotech companies are usually private, produce few profits and are usually started by groups of scientists specializing in certain areas of research. However, the research they conduct could lead to significant scientific breakthroughs, mountains of money and national prestige.” This package of bills provides these businesses with some tax relief in an effort to help get them off the ground.

Other press accounts have characterized the transformation of the state's economy (from one based on manufacturing to one based on the development of technology) as being "Michigan's evolution from brawn to brains." This transformation will help Michigan remain a leader in the automotive industry. Even while manufacturing plants are closing, the state can retain its status by becoming the center for automotive technology and research.

For:

These bills address the governor's criticisms of House Bills 5341 and 5343, which attempted to provide similar tax exemptions. Governor Granholm complained in her veto message that "the five-year tax exemption under [House Bills 5341 and 5343] would not begin until two years after a business initially qualifies for a single business tax reduction under House Bill 5331. As a result, the exemptions under these bills are disconnected for up to seven years from the condition rendering the business eligible for the exemption. To assure needed job creation in Michigan, tax incentives must be more focused and accurately targeted."

In response, House Bills 6025 and 6026 offer a more targeted approach by (subject to local approval) providing qualified start-up businesses with tax relief at the point in time when they most need tax relief. The bills do this by requiring that an application for an exemption contain an affidavit stating that the business qualifies for the SBT start-up credit (meaning that the business has no business income). Moreover, the bill requires the businesses to apply for the exemption annually, rather than providing an exemption for a full five year period, regardless of financial need.

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