

ECONOMIC DEVELOPMENT PROPOSAL AND BUSINESS TAX RELIEF AGREEMENT

**Description of Key Components
As Passed by the
House of Representatives**



**Prepared by the
Senate Fiscal Agency**

November 10, 2005

\$1.0 BILLION ECONOMIC DEVELOPMENT PROPOSAL
Description of Key Components

Content of Economic Development Proposal

1. Appropriate \$400.0 million in FY 2005-06 for economic development projects. This appropriation is financed by securitizing \$400.0 million of future tobacco settlement payments.
2. The \$400.0 million FY 2005-06 appropriation will be distributed in the following manner:
 - a. \$26.0 million as a grant to the Forest Finance Authority.
 - b. \$10.0 million for grants and loans to establish a Defense Contract Coordination Center.
 - c. \$3.0 million as a grant to the Van Andel Institute to complete a good manufacturing facility and continue funding marketing initiatives of the core technology alliance.
 - d. \$1.0 million as a grant program for implementation of new pharmaceuticals.
 - e. \$6.0 million for an automotive technology business accelerator.
 - f. \$2.0 million to promote the filming of motion pictures in Michigan.
 - g. \$2.0 million for technology transfer programs at universities.
 - h. \$15.0 million for additional tourism advertising.
 - i. \$10.0 million for the agricultural development fund.
 - j. \$3.5 million for the implementation of a capital access program.
 - k. \$90.0 million for life science technology. This appropriation is \$40.0 million in FY 2005-06 and \$50.0 million in FY 2006-07.
 - l. Up to \$16.0 million to the Michigan Economic Development Corporation for administrative cost of running the overall program.
 - m. \$20.0 million to the Michigan Economic Development Corporation for business development and marketing programs.

- n. The remaining \$195.5 million would be allocated by the Strategic Fund Board for loan guarantees, the small business capital access program, private equity investments, venture capital investments, mezzanine investment programs, and grants and loans for competitive edge technologies.
 - o. The State's General Fund would be the recipient of any interest earnings of any unallocated funding for economic development projects.
3. Beginning in FY 2007-08 and continuing on an annual basis through FY 2014-15, \$75.0 million a year of tobacco settlement revenue will be earmarked to the Strategic Fund Board. This funding totals \$600.0 million. Following an annual appropriation by the Legislature, these funds will be allocated by the Strategic Fund Board for loan guarantees, the small business capital access program, private equity investments, venture capital investments, mezzanine investment programs, and grants and loans for competitive edge technologies. During the period FY 2007-08 through FY 2011-12, a \$30.0 million allocation for life science technology shall be made from the portion allocated for competitive edge technologies. The Strategic Fund Board may expend not more than 4.0% of this funding in administrative costs and 5.0% for business development and marketing.
 4. A Michigan Life Sciences Pipeline will be created in the Michigan Strategic Fund. This program will promote the development of businesses providing goods and services related to the development and commercialization in the life sciences.
 5. The Business Corporation Act will be amended to reduce fees charged for the initial organization of firms or increased stock authorization within the State in order to promote and encourage new business activity in the State. A new, permissive expedited fee is also created.
 6. The Income Tax Act will be amended to create a new deduction equal to all or a portion of a gain realized from an initial equity investment of at least \$100,000 for investments made in Michigan competitive edge technology businesses.
 7. The Income Tax Act and the Single Business Tax Act will be amended to expand the Michigan Venture Fund which encourages venture capital investments in the State through the use of vouchers.

Fiscal Impact of the Economic Development Proposal

1. The securitization of \$400.0 million of the tobacco settlement revenue for economic development appropriations will result in debt service requirements of approximately \$40.0 million per year for the next 20 years. This is a projected total cost of \$800.0 million. These debt service payments will be made out of future tobacco settlement revenue beginning in FY 2006-07.
2. The \$75.0 million per year for eight fiscal years beginning in FY 2007-08 for economic development projects shall be funded by earmarking a portion of tobacco settlement revenue. This is a total cost of \$600.0 million.
3. The total cost of the \$1.0 billion economic development proposal over the next 20 years will be \$800.0 million of debt service for the cost of securitization and \$600.0 million for the eight years of funding for economic development projects.
4. The State budget impact of the economic development proposal is outlined in Table 1.

Table 1

Fiscal Impact of \$1 Billion Economic Development Proposal (millions of dollars)			
Fiscal Year	Securitization Debt Service	Tobacco Settlement Earmarking	Total Revenue Impact
2005-06	\$ 0.0	\$ 0.0	\$ 0.0
2006-07	40.0	0.0	40.0
2007-08	40.0	75.0	115.0
2008-09	40.0	75.0	115.0
2009-10	40.0	75.0	115.0
2010-11	40.0	75.0	115.0
2011-12	40.0	75.0	115.0
2012-13	40.0	75.0	115.0
2013-14	40.0	75.0	115.0
2014-15	40.0	75.0	115.0
2015-16	40.0	0.0	40.0
2016-17 through FY 2026-27	400.0	0.0	400.0
Total Tobacco Settlement Revenue Impact	\$800.0	\$600.0	\$1,400.0

BUSINESS TAX RELIEF AGREEMENT

Description of Key Components

Overall Fiscal Impact

- This business tax relief package would reduce business taxes by \$684.0 million during the six years from FY 2005-06 to FY 2010-11.
- Tax policy changes would generate \$211.0 million in additional revenue from businesses from FY 2005-06 to FY 2010-11.
- The proposed tax reductions and tax policy changes would result in a net business tax cut of \$472.0 million over the next six years.

Single Business Tax Cuts

- **Tax Rate Cut:** The single business tax rate would be reduced from 1.9% to 1.85% effective January 1, 2009.
- **Gross Receipts Deduction Decrease:** Under current law, a taxpayer may deduct the amount by which their adjusted tax base exceeds 50.0% of gross receipts. Under the agreement, the deduction would be reduced by increasing the gross receipts percentage from 50.0% to 51.4% on January 1, 2009.
- **Excess Compensation Deduction:** Currently, taxpayers may reduce their adjusted tax base by the percentage that compensation divided by the tax base exceeds 63.0%. Under the agreement this deduction would be reduced by making the deduction equal to the percentage that compensation divided by the tax base exceeds 64.7%, effective January 1, 2009.
- **Apportionment Factor:** Under current law, the apportionment factor, which is used to calculate an interstate business' activity in Michigan, is the weighted average of the business' percentage share of sales, property, and payroll that occur in Michigan. The sales factor is weighted at 90.0% and property and payroll are each weighted at 5.0%. Under the agreement, on January 1, 2006, the weight of the sales factor would increase to 95.0% and the weights on the property and payroll factors would decrease to 2.5%.
- **Industrial Personal Property Tax Credit:** A new tax credit for property taxes paid on industrial personal property would be created. The size of this refundable tax credit would be 15% of personal property taxes paid by industrial businesses.
- **Incentive for Moving Jobs to Michigan:** Businesses that transfer manufacturing or high technology jobs to Michigan would receive a 100% personal property tax credit on the personal property used by the transferred workers, as long as the property is new or new to Michigan. This credit could only be claimed in 2007 or 2008; however, it could be claimed in 2009 or 2010 if an agreement is reached with the MEDC.
- **Officer Compensation and the Small Business Credit:** One of the requirements to qualify for the small business credit is that a business must not

pay compensation to an officer or shareholder of more than \$115,000. Under this agreement, this would maximum compensation level would increase to \$125,000 beginning in 2006.

- **Adjusted Business Income and the Small Business Credit:** Another of the requirements to qualify for the small business credit is that a business' adjusted business income not exceed \$475,000. Under this agreement, the maximum adjusted business income level would increase to \$525,000 beginning in 2006.
- **Alternative Tax Rate:** Businesses that qualify for the small business credit may calculate their tax using an alternative method equal to 2.0% of their adjusted business income. Under this proposal the alternative tax rate would fall to 1.9% on January 1, 2006.
- **Health Care Cost Deduction:** The health care cost deduction, which currently equals 30.0% of the health care costs incurred by a business and is scheduled to increase to 40.0% in 2006 and 50.0% in 2007, would increase to 60.0% in 2009.
- **SBT Repeal:** The repeal of the single business tax scheduled to occur January 1, 2010, under current law would not be changed.

Tax Policy Changes

Sales and Use Taxes:

- Prison Script – Eliminate current sales tax exemption.
- Drivers Education Vehicles – Beginning January 1, 2006, the current sales and use tax exemptions on vehicles purchased or leased for driver education by public schools would be eliminated. This exemption would continue to be eliminated as long as the proposed new personal property tax credits are in effect, which means this exemption would be effective again beginning in 2010.
- International Phone Calls – Beginning January 1, 2006, the current use tax exemption on international calls, wide-area telecommunication services, and interstate private networks would be eliminated. This exemption would continue to be eliminated as long as the proposed new personal property tax credits are in effect, which means this exemption would be effective again beginning in 2010.
- Insurance Company Purchases – Beginning January 1, 2006, the current use tax exemption on insurance company purchases would be eliminated. This exemption would continue to be eliminated as long as the proposed new personal property tax credits are in effect, which means this exemption would be effective again beginning in 2010.

Single Business Tax:

- Small Business Credit Reduction – Limited Liability Companies (LLC) would be subject to the same requirements to qualify for the small business credit as all other types of businesses.
- Out-of-State Gains – Prohibit deduction of gains realized by out-of-state subsidiaries.

- Apprenticeship Tax Credit Reduction – The apprenticeship tax credit would be eliminated for all businesses except construction contractors.
- Carryforwards – Credit or loss carryforwards could not be claimed by businesses filing a consolidated return if they did not file a consolidated return when the carryforwards were created, under certain circumstances.

Tax Collection Penalties: Penalties on late tax payments would be increased for certain tax collections.

Commercial Rental Property: Commercial rental property would be exempt from the general property tax, and instead be subject to a new specific tax, beginning in 2006. This specific tax would be applied at the same millage rate as the property tax and would be distributed in the same way as the property tax. Under this proposed specific tax, the value of commercial rental property would be allowed to be increased for occupancy increases, but only to the extent that they have incurred decreases in value due to occupancy declines. The courts have ruled that under the current property tax, the Constitution prohibits increases in value in excess of the lesser of inflation or 5.0% due to increasing occupancy rates.

BUSINESS TAX RELIEF AGREEMENT

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(dollars in millions)

Tax Change	FY 2005-06	FY2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	Total
TAX POLICY CHANGES AND TAX CUTS							
Tax Policy Changes							
Sales/Use Taxes							
Eliminate Prison Script Exemption	\$0.5	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8	\$4.4
Eliminate Driver Ed. Vehicle Exemption	0.5	0.6	0.6	0.6	0.1	0.0	2.4
Eliminate International Phone Call Exemption	10.6	14.5	15.0	15.4	4.0	0.0	59.4
Eliminate Insurance Company Exemption	<u>2.3</u>	<u>3.1</u>	<u>3.2</u>	<u>3.3</u>	<u>0.8</u>	<u>0.0</u>	<u>12.6</u>
Subtotal Sales/Use Taxes	13.8	19.0	19.5	20.0	5.7	0.8	\$78.8
Single Business Tax							
Small Business Credit Reduction (LLCs)	3.8	5.1	5.3	5.5	1.4	0.0	\$21.1
Prohibition on Subsidiary Out-of-state Gains Deduction	8.3	11.3	11.7	12.1	3.1	0.0	46.6
Apprenticeship Credit Reduction	0.5	0.6	0.6	0.6	0.2	0.0	2.4
Credit/Loss Carryforward Restriction	<u>3.8</u>	<u>5.1</u>	<u>5.3</u>	<u>5.5</u>	<u>1.4</u>	<u>0.0</u>	<u>21.0</u>
Subtotal SBT	16.4	22.1	22.8	23.7	6.1	0.0	91.1
Enhanced Penalties	3.8	5.1	5.3	5.5	5.7	5.9	31.3
Taxes on Commercial Rental Property	<u>0.0</u>	<u>0.0</u>	<u>1.0</u>	<u>2.0</u>	<u>3.0</u>	<u>4.0</u>	<u>10.0</u>
TOTAL TAX POLICY CHANGES	\$34.0	\$46.1	\$48.6	\$51.2	\$20.6	\$10.8	\$211.2
Tax Cuts							
Single Business Tax							
Tax Rate Cut 1)	\$0.0	\$0.0	\$0.0	(\$44.6)	(\$15.5)	\$-0.0	(\$60.2)
Reduce Gross Receipts&Excess Comp Deducts 2)	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>19.5</u>	<u>6.7</u>	<u>0.0</u>	<u>26.2</u>
Subtotal Tax Rate, Gross Recpts & Ex Comp Deduct Cuts	0.0	0.0	0.0	(25.1)	(8.8)	0.0	(34.0)
Increase Sales Tax Apportionment Factor to 95% 3)	(16.1)	(22.0)	(23.0)	(24.0)	(6.2)	0.0	(91.3)
Reduce Health Care in Base 4)	0.0	0.0	0.0	(7.7)	(2.6)	0.0	(10.3)
Small Business Credit Officer Pay Increase 5)	(2.0)	(2.7)	(2.7)	(2.8)	(0.7)	0.0	(11.0)
Small Business Adjusted Business Income 6)	(2.0)	(2.7)	(2.7)	(2.8)	(0.7)	0.0	(11.0)
Industrial Personal Property Tax Credit (refundable) 7)	(75.0)	(120.0)	(120.0)	(120.0)	(30.0)	0.0	(465.0)
Incentive for New Property Investment	0.0	(25.0)	(25.0)	0.0	0.0	0.0	(50.0)
Alternative Tax Rate Cut 8)	<u>(2.0)</u>	<u>(2.7)</u>	<u>(2.7)</u>	<u>(2.8)</u>	<u>(0.7)</u>	<u>0.0</u>	<u>(11.0)</u>
TOTAL TAX CUTS	(\$97.1)	(\$175.0)	(\$176.2)	(\$185.3)	(\$49.9)	\$0.0	(\$683.6)
NET IMPACT - TAX POLICY CHANGES AND TAX CUTS	(\$63.2)	(\$128.9)	(\$127.6)	(\$134.1)	(\$29.3)	\$10.8	(\$472.3)

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November 10, 2005

(dollars in millions)

Notes:

SBT - The scheduled repeal of the single business tax beginning 1/1/2010 would not be changed.

- 1) Tax rate would be cut 0.05 percentage point to 1.85% 1/1/09.
- 2) Excess compensation deduction would be reduced from excess over 63% to excess over 64.7%, and gross receipts deduction would be reduced from excess over 50% to excess over 51.4%.
- 3) Sales factor would increase from 90% to 95% on 1/1/06.
- 4) Health care cost deduction would be increased to 60% in 2009.
- 5) Small business credit officer pay limit would increase from \$115,000 currently to \$125,000 in 2006.
- 6) Small business adjusted business income threshold would increase from the current \$475,000 to \$525,000 in 2006.
- 7) Industrial personal property tax credit would be refundable at 15% of personal property taxes paid.
- 8) Alternative tax rate would be reduced from current 2.0% to 1.9% 1/1/06.

FY 2005-06 FY2006-07 FY 2007-08 FY 2008-09 FY 2009-10a FY 2010-11

Summary of Tax Changes (effective Jan. 1):

SBT Tax Rate (currently 1.9%)	1.90%	1.90%	1.90%	1.85%	1.85%	No SBT
Alternate SBT Tax Rate (currently 2.0%)	1.90%	1.90%	1.90%	1.90%	1.90%	No SBT
Excess Comp Deduction threshold % (currently 63%)	63.0%	63.0%	63.0%	64.5%	64.5%	No SBT
Gross Receipts Deduction threshold % (currently 50%)	50.0%	50.0%	50.0%	51.4%	51.4%	No SBT
Apportionment Sales Factor (currently 90%)	95.0%	95.0%	95.0%	95.0%	95.0%	No SBT
Health Care Cost % Deducted (currently 40% '06, 50% '07)	40.0%	50.0%	50.0%	60.0%	60.0%	No SBT
Small Business Credit Officer Pay Limit (currently \$115,000)	\$125,000	\$125,000	\$125,000	\$125,000	\$125,000	No SBT
Small Business Adjusted Business Income Threshold (\$475,000)	\$525,000	\$525,000	\$525,000	\$525,000	\$525,000	No SBT

a) SBT would be repealed 1/1/2010, as scheduled under current law.

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