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MEGA, TARGETED TAX CREDITS

House Bill 4494 (Substitute H-1)
Sponsor: Rep. Beverly Hammerstrom

House Bill 4495 (Substitute H-2)
Sponsor: Rep. John Llewellyn

Committee: Commerce

First Analysis (3-14-95)

THE APPARENT PROBLEM:

Michigan's ability to retain and attract business investment relies on numerous factors, including such things as the quality of its work force, the strength of its transportation system, and the vitality and diversity of its economic base. When companies, whether in-state firms or those from elsewhere, plan to grow their operations and are searching for the best place to locate, however, they often will decide to locate or expand based on a state's overall tax burden. Despite tax cuts enacted in recent years, Michigan is still considered a relatively high tax state, particularly for business taxes. Just recently, for instance, a Michigan community that was a leading contender in the race to land a proposed steel mill was disappointed after the firm chose to locate its mill in Toledo, Ohio. The mill represented a total investment of over $400 million and reportedly would have created 350 high-wage full-time jobs, not to mention the economic boost to the local community from spinoff activity. Apparently, other Michigan communities have been turned down for major business expansion/relocation plans, too. According to a business survey conducted by the Greater Detroit Chamber of Commerce, companies that had relocated from Michigan to Indiana cited the lack of some kind of economic incentive program as the primary reason for moving or expanding their operations outside the state. Currently, 44 states use tax incentives for attracting and keeping business investment, including nearly all of the states (not Wisconsin) that compete directly with Michigan for businesses and jobs. To help level the playing field in this fierce fight for jobs and economic growth, some have called for the creation of a special board, the Michigan Economic Growth Authority, that would be authorized to issue tax credits for up to 20 years under the Single Business Tax Act to companies that met certain criteria and agreed to expand or locate new facilities, and create new jobs, in the state.

THE CONTENT OF THE BILLS:

The bills would 1) provide for the creation of the Michigan Economic Growth Authority (MEGA), whose primary purpose would be to "determine which businesses qualify for tax credits" under the provisions of House Bill 4494 and what the amount and duration of those credits would be, and 2) amend the Single Business Tax Act to provide two tax credits to an "authorized business"--that is, a taxpayer determined by MEGA to qualify for the credit under the provisions of House Bill 4495. One of the tax credits would be based on the amount of income tax revenue attributable to new employees and the other on the increased SBT liability attributable to increased business activity and new jobs. A company certified by MEGA before December 31, 1998, could get the tax credits for up to 20 years.

<u>House Bill 4495</u> would create the Michigan Economic Growth Authority Act to provide for the creation of MEGA, an eight-member board within the Michigan Jobs Commission. The commission would be charged with providing staff for the authority and would carry out the administrative duties and functions as directed by the authority, and the commission director would supervise budgeting, procurement, and related functions of the authority.

The MEGA board would consist of the state treasurer and the directors of the Jobs Commission, Department of Management and Budget, and Department of Transportation, and four other members appointed by the governor--who were not state employees--who had knowledge, skill, and experience in academic, business, local government, labor, or financial fields. MEGA members could not be compensated for their services, but the authority could reimburse members for expenses related to performing their duties.

MEGA powers. In addition to other powers specified in the bill, MEGA would be empowered and responsible to do the following:

* Authorize eligible businesses to receive tax credits to foster job creation in the state;

* Determine which businesses qualified for tax credits, and the amount and duration of them;

* Enter into written agreements specifying the conditions under which tax credits were authorized and the circumstances under which they could be reduced or eliminated;

* Charge and collect reasonable administrative fees;

* Delegate to MEGA's chairperson, staff, or others functions and powers it deemed necessary and appropriate to administer the program;

* Promulgate rules pursuant to the Administrative Procedures Act necessary to carry out the bill's purposes; and

* Assist eligible businesses to obtain the benefits of a tax credit, incentive, or inducement program provided by the bill or under House Bill 4494.

The bill would define an "eligible business" as one that, after the bill's effective date, proposed to create new jobs in the state in manufacturing, research and development, wholesale and trade, or office operations. The term, however, would not include retail establishments or that portion of an eligible business used exclusively for retail sales, nor would it include businesses that had defaulted on tax liabilities to the state or its local governments.

Criteria for authorization. An eligible business could apply to MEGA to enter into a written agreement authorizing a tax credit, and after receiving an application MEGA could enter into an agreement with an eligible business for a tax credit if it determined that all of the following conditions were met:

* The eligible business created a minimum of 75 qualified new jobs if it were expanding in the state or 150 new jobs if it were newly locating here, within 12 months of expanding or locating as determined by MEGA, and agreed to maintain these jobs for each year tax credits were received under the bill's provisions;

* The eligible business, if already located here, agreed to maintain (in addition to the 75 jobs created from expanding) a number of full-time jobs equal to or greater than the number it had maintained in the state prior to expanding, as determined by MEGA;

* The eligible business paid for all qualified new jobs an average wage that was equal to or greater than 150 percent of the federal minimum wage;

* The expansion or location of an eligible business would not have occurred in the state without the tax credits offered by the bill;

* The local governmental unit in which an eligible business was to expand or be located--or a local economic development corporation or similar entity--made a financial or economic commitment to the business for its expansion or location;

* Financial statements of the eligible business indicated that it was financially sound and that its plans to expand or relocate were economically sound;

* The eligible business had not begun construction or publicly announced a specific siting of its facility;

* An eligible business' expansion or location would benefit the state's people by increasing work opportunities and improving the state's economy;

* Tax credits offered by the bill were an incentive to expand or locate the eligible business in Michigan and address the competitive disadvantages with sites outside the state;

* A cost/benefit analysis revealed that authorizing the eligible business to receive tax credits under the bill would result in an overall positive fiscal impact to the state.

An "authorized business" would be defined as "an eligible business with which [MEGA] has entered into a written agreement for a tax credit" provided in House Bill 4494.

If MEGA determined that requirements for authorizing the credit were met, it would have to determine the amount and duration of tax credits (not to exceed 20 years) to be authorized and enter into a written agreement with the eligible business. In determining the amount and duration of the tax credits, MEGA would have to consider: 1) the number of qualified new jobs to be created; 2) the average wage level of those jobs relative to the average wage paid by private entities in the county where the facility was located; 3) the total capital investment the eligible business was to make; 4) the cost differential to the business between expanding or locating in the state versus somewhere else; 5) the potential impact of the expansion/location on the state's economy; and 6) the cost of the tax credit, the financial/economic assistance provided by the local government, economic development corporation or similar entity, and the value of assistance otherwise provided by the state.

Written agreement. A written agreement between an eligible business and MEGA would have to include at least all of the following:

* A description of the business expansion or location that would be subject to the agreement;

* Conditions upon which the authorized business designation was made;

* A statement by the eligible business that violating the agreement could cause its authorized designation to be revoked and the loss or reduction of future credits;

* A statement by the business that a misrepresentation in the application could result in its designation being revoked and the refunding of credits it had received;

* A method for measuring full-time jobs prior to and after an expansion or location of an authorized business in the state.

Issuance of certificate. Once the written agreement was executed, an eligible business would be an authorized business and be eligible to receive the tax credits provided under House Bill 4495. MEGA would have to issue a certificate each year to an authorized business that stated 1) that the eligible business was an authorized business, and 2) the amount of the tax credit for the designated tax year.

However, an authorized business would not be eligible for a tax credit and MEGA could not issue a certificate to a business unless it reported annually to the Department of Treasury the cost of the tax credit per company employee, whether the authorized business was receiving an abatement of ad valorem taxes under the Plant Rehabilitation and Industrial Development Act (also known as P.A. 198 abatements), and the amount of state job training grants, sales and use tax exemptions, and all other state tax benefits received that year per company employee.

Open meetings, FOIA. MEGA would have to hold public meetings for all its business in compliance with the Open Meetings Act, and the public would have to be notified of the time, date, and place of such meetings. The bill, however, provides that a record or portion of a record, material, or other data received, prepared, used, or retained by MEGA relative to a tax credit that related to financial or proprietary information submitted by an applicant and "acknowledged by [MEGA] as confidential" would not be subject to disclosure requirements of the Freedom of Information Act.

Also, MEGA could meet privately to determine whether it acknowledged as confidential any financial or proprietary information submitted by an applicant for the tax credit which the applicant considered confidential, but could not acknowledge "routine financial information" (not defined by the bill) as being confidential, unless it was considered proprietary information. The bill specifically would bar MEGA from disclosing financial or proprietary information not subject to disclosure without an applicant's consent.

The bill would define "financial or proprietary information" as information that was not "publicly disseminated or is unavailable from other sources," which, if released, could cause the applicant "significant competitive harm." The term would not, however, include a written agreement under the bill's provisions.

Report to legislature. The bill would require MEGA to report to both the House and Senate on October 1 of each year regarding its activities and provide them a list of all businesses it authorized under the bill's provisions.

House Bill 4494 would add two new sections to the Single Business Tax Act (MCL 208.37c and 208.37d) that would specify the following:

** For tax years beginning after December 31, 1994, an authorized business could credit against SBT liability the amount certified each year by MEGA, which could not exceed the payroll of the authorized business attributable to employees who fill qualified new jobs multiplied by the tax rate. (The "tax rate" would be the rate imposed under Section 51(1) of the Income Tax Act for the tax year that included the beginning of the taxpayer's tax year for which the credit was being computed.) This would be a refundable credit; that is, any amounts exceeding total tax liability would be refunded to the taxpayer. The bill further specifies that an affiliated group, a controlled group of corporations, or an entity under common control would be entitled to only one of these credits for each tax year for expansion or location evidenced by a written agreement whether or not a combined or consolidated return was filed.

** For tax years beginning after December 31, 1994, an authorized business could credit against SBT liability an amount equal to the tax liability attributable to authorized business activity. (That liability would be defined as the taxpayer's liability after existing allowable credits multiplied by a fraction, the numerator of which would be the ratio of the value of the new facility to all property located in the state plus the ratio of payroll attributable to new jobs to all payroll, and the denominator of which would be 2.) However, this credit would not be refundable but could be used to offset tax liability in future years--for up to 10 years or until used up, whichever came first--in cases where the credit exceeded the taxpayer's tax liability for a given tax year.

A taxpayer could not claim the credits unless MEGA had issued a certificate to the taxpayer, and the taxpayer would have to attach the certificate to a return on which the credit was being claimed. The certificate would have to state 1) that the taxpayer was an authorized business, 2) the amount of the credit for the business for the designated tax year, and 3) the taxpayer's federal employer identification number or the state treasury number assigned.

FISCAL IMPLICATIONS:

The House Fiscal Agency says both bills would have fiscal implications for the state. The cost to the state for issuing tax credits under the provisions of House Bill 4494 could not be determined and would depend on the number of businesses certified by MEGA as eligible for the credits as well as the terms of those credits negotiated by MEGA. The agency estimates new credits issued each year "could easily cost the state $8 million per year for 20 years." Using the assumption that credits worth $8 million per year were granted annually for 4 years, and the credits were good for 20 years, it is estimated the bill's "net present value" (its total accumulated cost to the state in current dollars) would be approximately $450 million. The agency said House Bill 4494 also would have local fiscal implications as reductions in total SBT revenues would reduce the amount of total state revenues dedicated to local revenue sharing. (3-14-95) The agency says House Bill 4495 would have minimal fiscal impact to the state as members and staff of MEGA would have to be reimbursed for expenses related to performing their official duties. (3-9-95)

The Michigan Jobs Commission estimates the state would forego between $6 and $13 million in SBT tax revenue annually under House Bill 4494, but that the state could recoup these revenues in later years. Over the long term, the commission believes the bill would, in fact, generate additional tax revenue to the state, although how much could not be determined. (3-13-95)

ARGUMENTS:

For:

The bills would help Michigan better compete for business expansion and the jobs created when companies expand or relocate by offering tax credits to companies that meet various criteria, including a commitment to create and maintain either 75 or 150 new full-time, high-wage jobs in the state, depending on whether a company was expanding its Michigan operations or was an out-of-state company looking to locate new facilities here. House Bill 4495 would create an eight-member board, known as the Michigan Economic Growth Authority (MEGA), whose primary responsibility would be to take applications from companies interested in qualifying for the credit and decide which ones met the established criteria. Under the bill, once an "eligible business" was determined to qualify, it would be authorized to receive refundable single business tax credits for up to 20 years, as provided in House Bill 4494. House Bill 4495, however, would require authorized businesses to enter into a written agreement with MEGA providing that failure to meet all the requirements in the bill could result in the company losing its authorized status as well as all or a portion of its credits. The bills recognize the fact that, even as Michigan moves to cut taxes and transform itself into a more business-friendly state, it faces fierce competition in the fight to attract businesses and jobs from other states with tax incentive programs similar to that proposed in the bills. And even though the state initially would forego millions of dollars in revenues by offering the tax credits, it is expected it would both recoup those losses as well as increase tax receipts in future years as authorized companies, and businesses affected from their presence--as well as the people who fill the jobs created from both--paid other state and local taxes. The bills would enable Michigan to compete for business investment and jobs on a par with other states as it works to improve its overall business climate by lowering taxes and removing regulatory barriers to economic growth.

For:

The bills not only would be good for "big business" in the state, in that the tax credits could only be granted to companies with major facility expansion plans, but also could benefit the small business community as spin-off jobs would be created in areas where authorized businesses expanded or located. Further, as tax credits would apply only to expected future tax liability from new jobs created, small businesses could be assured the bills would not simply be favoring bigger businesses at their expense. Any new jobs created by authorized companies, ultimately, will create new business opportunities for smaller businesses such as restaurants, service providers, and others that are located near the new facilities. And finally, local governments--particularly those in rural areas--could benefit from capital expansion that occurs in their jurisdictions due to the resulting increase in local property tax revenues that would be generated from new economic growth.

Against:

The bills would foster a form of government industrial policy in which the state would pick winners and losers in an attempt to promote future economic growth. Rather than offering gimmicks such as tax credits that would benefit only a handful of companies, the state would have a better chance of attracting new businesses and retaining existing ones simply by reducing overall state and local tax levels, reforming its unemployment insurance laws, cutting regulations that stifle economic growth, and improving the quality of its work force by guaranteeing students are educated properly. In fact, using tax incentives to lure business development could impede progress to cut taxes further if state officials believed the state could not afford to do both. Furthermore, House Bill 4495 proposes to grant broad authority to MEGA, which would be made up of political appointees chosen by the governor to determine tax policy for a few Michigan companies. In fact, the whole premise of creating a new state agency, and the bureaucracy required to sustain it, in order to promote economic growth runs counter to sound fiscal policy. The state also could find itself fighting expensive court battles if some companies felt they were unfairly denied tax credits while others were granted them. The bill could end up doing more economic harm than good for the state if, after numerous tax credits were issued, companies decided they could get a better deal elsewhere. Or, perhaps worse, companies that accepted tax credits could later threaten to leave unless the state and its local governments offered additional financial or economic incentives.

Response:

While some theorize about whether or not the state would be wise to adopt a program like MEGA, other states are "living in the real world" by using similar financial- incentive tools to win businesses and jobs. Forty-four other states currently use MEGA-like tax incentives, and these bills would merely level the playing field. As for the argument that some companies could decide to leave after being granted tax credits, this would seem unlikely once a company had invested hundreds of millions of dollars to locate in the first place. But even if this were to happen, the state would at least have benefited from a company's initial move here, which most likely would not even occur unless tax credits were there to draw them.

Against:
Some argue the bills would mostly help communities that lie along the state's borders, particularly those along its southern border, attract business development, while ignoring economic development concerns of central and northern areas of the state. Also, some believe it is unfair to offer tax incentives to larger companies that expand without doing the same for smaller businesses.

Response:
These concerns seem unjustified as there are communities in central and northern areas of the state currently vying for proposed business expansions which would benefit greatly from the bills. Also, though small businesses would not directly benefit under the bills, they would realize indirect benefits from increased economic activity in areas that lured new facilities under the bills' provisions.

Against:
The bills are flawed for various reasons, among them:

* House Bill 4495 fails to limit the number or dollar amount of total tax credits that could be issued to companies in a given year, which would grant MEGA unlimited authority to dole out tax breaks to companies even if it would ultimately harm the state. Reportedly, the Jobs Commission has suggested limiting the dollar amount of tax credits that could be granted to no more than $8 million per year.

* House Bill 4495 specifies that, if a company violated the written agreement or in some way misrepresented itself in applying for tax credits, MEGA "may" nullify its authorized status and diminish or void its tax credits. This language would seem to grant MEGA too much leeway in deciding how, or even whether, to punish companies that failed to meet all the bill's requirements. The bill, instead, should require MEGA to take corrective action in such situations.

* As it is difficult to determine the fiscal impact to the state of granting such tax credits, particularly over the long term, House Bill 4494 should be amended to reduce the duration that tax credits could be granted from up to 20 years to no more than 10 years.

POSITIONS:

The Michigan Jobs Commission supports the bills. (3-13-95)

The Michigan Manufacturers Association has indicated its endorsement of the MEGA concept. (2-23-95)

Detroit Renaissance, a nonprofit, private civic organization that focuses on various business issues affecting larger corporations in the Detroit area, supports the bills. (3-13-95)

The Michigan Economic Developers Association supports the bills. (3-13-95)

The Greater Detroit Chamber of Commerce supports the bills. (3-6-95)

The Monroe County Industrial Development Corporation supports the bills. (3-8-95)

The Village of Dundee supports the bills. (3-7-95)

The National Federation of Independent Business/Michigan, which is the nation's largest small-business advocacy organization, supports the bills. (3-13-95)

The Michigan State Chamber of Commerce has serious concerns about the bills and does not support them. (3-13-95)

The Mackinac Center for Public Policy, a Midland-based research and educational organization, opposes the bills. (3-13-95)