



Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536



Telephone: (517) 373-5383
Fax: (517) 373-1986

House Bills 4368 and 5099 through 5102 (Substitute H-1 as passed by the House)

Sponsor: Representative Greg VanWoerkom (H.B. 4368)

Representative Rachel Hood (H.B. 5099)

Representative Jasper Martus (H.B. 5100)

Representative Julie M. Roberts (H.B. 5101)

Representative Ranjeev Puri (H.B. 5102)

House Committee: Tax Policy (discharge) (H.B. 4368)

Economic and Community Development (H.B. 5099-5102)

Senate Committee: Committee of the Whole

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INTRODUCTION

The bills would establish a Research and Development (R&D) tax credit for eligible taxpayers and employers. Taxpayers and authorized businesses with 250 or more employees could claim up to \$2.0 million per taxpayer or business, respectively, per year. Taxpayers and authorized businesses with fewer than 250 employees could claim up to \$250,000 per taxpayer or business, respectively, per year. Additionally, taxpayers or employers could claim up to \$200,000 in an additional credit for expenses from collaboration with a research university. The aggregate amount of R&D credits could not exceed \$100.0 million, and if they did, the Department of Treasury (DoT) would have to prorate the credits as prescribed by the bills. The bills would require the DoT to submit an annual report concerning the effectiveness and operation of the proposed R&D tax credits.

BRIEF FISCAL IMPACT

The bills would have negative fiscal impact on State government and an indeterminate fiscal impact on local units of government. Revenue to the General Fund and the School Aid Fund would be reduced by approximately \$100.00 million per tax year. Most of this revenue loss would be concentrated in the General Fund. In addition, the bills would increase administrative costs to the DoT and to the Michigan Strategic Fund (MSF).

Proposed MCL 206.716 (H.B. 4368)

MCL 125.2009 (H.B. 5099)

Proposed MCL 206.677 (H.B. 5100)

Proposed MCL 206.717 (H.B. 5101)

Proposed MCL 206.718 (H.B. 5102)

Legislative Analyst: Eleni Lionas

Fiscal Analyst: Elizabeth Raczkowski

Cory Savino, PhD

David Zin

CONTENT

House Bill 4368 (H-1) would amend the Income Tax Act to define terms that would apply to the provisions of **House Bill 5100 (H-1)** and **House Bill 5101 (H-1)**.

House Bill 5099 (H-1) would amend the Michigan Strategic Fund Act to require the MSF to cooperate with the DoT and assist in preparing the report described under **House Bill 5102 (H-1)**.

House Bill 5100 (H-1) would amend the Income Tax Act to create an R&D tax credit for an eligible taxpayer beginning on or after January 1, 2024, and do the following:

- Allow taxpayers with 250 or more employees to claim up to \$2.0 million per taxpayer per year.
- Allow taxpayers with fewer than 250 employees to claim up to \$250,000 per taxpayer per year.
- Allow an eligible taxpayer to claim an additional credit of up to \$200,000 if the expenses were incurred in collaboration with a research university pursuant to a written agreement between the taxpayer and university.
- Require a taxpayer to submit a tentative claim to the DoT for eligibility and require the report to contain certain information pertaining to the taxpayer and the incurred R&D expenses.
- Prohibit the total amount of R&D credits from exceeding \$100.0 million and require the DoT to prorate credits as prescribed by the bill if they exceeded \$100.0 million.
- Prohibit a taxpayer from assigning or transferring any portion of the credit.
- Require a taxpayer to file a claim on the taxpayer's annual return.
- Prescribe that, if the credit amount exceeded the tax liability of the taxpayer for the filed year, the portion that exceeded the liability would have to be refunded.

House Bill 5101 (H-1) would amend the Income Tax Act to create an R&D tax credit for an eligible employer beginning on or after January 1, 2024, and do the following:

- Allow an authorized business with 250 or more employees to claim up to \$2.0 million per employer per year.
- Allow an authorized business with fewer than 250 employees to claim up to \$250,000 per employer per year.
- Allow an employer to claim an additional credit of up to \$200,000 if the expenses were incurred in collaboration with a research university pursuant to a written agreement between the taxpayer and university.
- Require an employer to submit a tentative claim to the DoT for eligibility and require the report to contain certain information pertaining to the taxpayer and the incurred R&D expenses.
- Prohibit the total amount of R&D credits from exceeding \$100.0 million and require the DoT to prorate credits as prescribed by the bill if they exceeded \$100.0 million.
- Prohibit a member of a flow-through entity that submitted a claim for an R&D credit from claiming any portion of the credit.
- Prohibit an employer from assigning or transferring any portion of the credit.
- Require an employer to file a claim on the taxpayer's annual return.
- Prescribe that if the credit amount exceeded the tax liability of the taxpayer for the filed year, the portion that exceeded the liability would have to be refunded.

House Bill 5102 (H-1) would amend the Income Tax Act to require the DoT, in cooperation with the MSF, to submit to the Legislature, the Governor, and the Senate and House fiscal agencies an annual report concerning the operation and effectiveness of the R&D tax credits, by July 1 of each year.

House Bill 4368 (H-1)

The bill would add the terms described below to Chapter 17 of the Income Tax Act and specify that the terms would also apply to House Bill 5100 (H-1). (Generally, Chapter 17 prescribes withholding requirements for employers, flow-through entities, casino licensees, race meeting licensees, track licensees, and eligible production companies.)

"Authorized business" would mean the following:

- Unless otherwise provided, for the purpose of a credit proposed by House Bill 5101 (H-1), a flow-through entity that is subject to the withholding requirements of Section 703(2) and has increased its qualifying research and develop expenses.
- For the purposes of a credit proposed by House Bill 5100 (H-1), a taxpayer that has increased its qualifying research and development expenses.

(Generally, Section 703(2) prescribes withholding requirements for employers that are required under the Internal Revenue Code to withhold taxes on individuals' compensation.)

"Taxpayer" would mean a corporation, insurance company, financial institution, or unitary business group, whichever is applicable under each chapter, that is liable for a tax, interest, or penalty under Part 2.

"Base amount" would mean the average annual amount of qualifying research and development expenses during the three calendar years immediately preceding the calendar year ending with or within the tax year for which a credit is being claimed under House Bill 5100 (H-1) or House Bill 5101 (H-1). An authorized business with no prior qualifying research and development expenses would have a base amount of zero. If qualifying research and development expenses were incurred in only one or two of the immediately preceding three calendar years, the average annual amount would have to be based on the number of calendar years during which qualifying research and development expenses were incurred.

"Qualifying research and development expenses" would mean the sum of in-house research expense and contract research expense amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer in the State.¹ The term would not include qualified research expenses for research conducted outside of the State.

"Research university" would mean a public university described in Section 4, 5, or 6 of Article VIII of the State Constitution of 1963 or an independent nonprofit college or university in the State. (Sections 4, 5, and 6 apply to the University of Michigan, Michigan State University, Wayne State University, Eastern Michigan University, Michigan College of Science and Technology, Central Michigan University, Northern Michigan University, Western Michigan University, Ferris Institute, Grand Valley State College, institutions of higher education, and institutions with the authority to grant baccalaureate degrees.)

¹ See Section 41(b) of the Internal Revenue Code, 26 USC 41.

House Bill 5100 (H-1)

Taxpayer R&D Credit

Under the bill, for tax years beginning on or after January 1, 2024, a taxpayer that was an authorized business could claim a credit against a tax imposed under Part 2 in an amount equal to the sum of an amount equal to 3% of the taxpayer's qualifying R&D expenses incurred during the calendar year ending with or within the tax year up to the base amount and the product of the taxpayer's qualifying research and development expenses incurred during the calendar year ending with or within the tax year in excess of the base amount, multiplied by the following percentages in the following amounts:

- For a taxpayer with 250 or more employees, 10%; the credit could not exceed \$2.0 million per tax year per taxpayer.
- For a taxpayer with fewer than 250 employees, 15%; the credit could not exceed \$2.5 million per tax year per taxpayer.

Additional Credit

Subject to the bill's limitations, a taxpayer that claimed an R&D tax credit could claim an additional credit equal to 5% of the qualifying R&D expenses incurred during the calendar year ending with or within the tax credit year that were greater than the base amount if the taxpayer's qualified R&D expenses claimed under the credit were incurred in collaboration with a research university pursuant to a written agreement between the taxpayer and university.

To claim the additional credit, if requested by the DoT, the taxpayer would have to provide the DoT with a copy of the written agreement with the research university. The additional credit could not exceed \$200,000 per taxpayer per year.

Tentative Claim

To be eligible for the taxpayer R&D tax credit, a taxpayer would have to submit, in a form and manner as prescribed by the DoT, a tentative claim for which an R&D tax credit was sought to the DoT on or before March 15 after the calendar year ending with or within the tax year for which the taxpayer intended to submit a claim for the credit on the taxpayer's annual return. The tentative claim would have to include all the following information:

- The amount of qualifying R&D expenses incurred for which a credit were being claimed.
- If the credit were to be claimed by a taxpayer with more or less than 250 employees.
- If an additional credit were claimed for collaboration with a research university.

The DoT would have to review all tentative taxpayer R&D claims submitted and if the amount of tentative claims submitted exceeded \$1.0 million, the DoT would have to publish a notice on its website notifying taxpayers of the adjustment to the tentative claims for that calendar year.

Aggregate Credit Amount

The aggregate amount of credits allowed to be claimed by all taxpayers and all employers under House Bill 5101 (H-1) based on qualifying R&D expenses incurred in a single calendar year could not exceed \$100.0 million. If the aggregate amount of taxpayer R&D credits and employer R&D credits under House Bill 5101 (H-1) credits exceeded \$100.0 million, the DoT would have to prorate the amount of credits allowed for each claimant as follows:

- If the aggregate amount of credits claimed by all taxpayers with fewer than 250 employees qualifying under the bill and all employers with fewer than 250 employees qualifying under House Bill 5101 (H-1) did not exceed \$25.0 million, the amount of credits claimed by each of those claimants could not be prorated; however, for taxpayers with 250 or more employees claiming a credit under the bill or employers with 250 or more employees claiming a credit under House Bill 5101 (H-1), the amount of credits claimed would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of the remaining amount of credits allowed to be claimed under the bill and the aggregated amount of R&D credits.
- Except as otherwise provided, if the aggregate amount of credits claimed by all taxpayers with fewer than 250 employees qualifying under the bill and all employers with fewer than 250 employees qualifying under House Bill 5101 (H-1) exceeded \$25.0 million, the amount of credits claimed by each of those claimants would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of \$25.0 million, and the amount of credits claimed by each taxpayer with 250 or more employees claiming a credit under the bill or employers with 250 or more employees claiming a credit under House Bill 5101 (H-1) would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of \$75.0 million.
- If the aggregate amount of credits claimed by all taxpayers with fewer than 250 employees qualifying under the bill and all employers with fewer than 250 employees qualifying under House Bill 5101 (H-1) exceeded 25% of the aggregate amount of credits claimed by all taxpayers under this provision and employers under House Bill 5101 (H-1), then the proration described directly above would not apply and the amount of credits claimed by each taxpayer under this provision and employer under House Bill 5101 (H-1) would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of \$100.0 million

A taxpayer could not assign or transfer all or any portion of a taxpayer R&D tax credit. Under the bill, the taxpayer R&D credit or any portion of the credit would not be assignable or transferable either by agreement or by operation of law.

A taxpayer would have to, in a form and manner as prescribed by the DoT, file a claim for a credit under these provisions with the annual return required to be filed under Part 2 for the same tax year for which a taxpayer R&D credit was claimed. The taxpayer R&D credit would have to be claimed after all allowable nonrefundable credits under Part 2. If the amount of the credits allowed under this section exceeded the tax liability of the taxpayer for the tax year, that portion of the credit that exceeded the tax liability of the taxpayer for the tax year would have to be refunded.

House Bill 5101 (H-1)

Taxpayer R&D Credit

Under the bill, for tax years beginning on or after January 1, 2024, an employer that was an authorized business could claim a credit against the taxes required to be withheld and remitted to the State under Chapter 17 in an amount equal to the sum of an amount equal to 3% of the employer's qualifying R&D expenses incurred during the calendar year ending with or within the tax year up to the base amount and the product of the employer's qualifying R&D expenses incurred during the calendar year ending with or within the tax year in excess of the base amount, multiplied by the following percentages in the following amounts:

- For an authorized business with 250 or more employees, 10%; the credit could not exceed \$2.0 million per tax year per employer.

- For an authorized business with fewer than 250 employees, 15%; the credit could not exceed \$250,000 per tax year per employer.

Additional Credit

Subject to the limitations of the bill, an employer that claimed an R&D tax credit could claim an additional credit equal to 5% of the qualifying R&D expenses incurred during the calendar year ending with or within the tax credit year that were greater than the base amount if the employer's qualified R&D expenses claimed under the credit were incurred in collaboration with a research university pursuant to a written agreement between the employer and university.

To claim the additional credit, if requested by the DoT, the employer would have to provide the DoT with a copy of the written agreement with the research university. The additional credit could not exceed \$200,000 per taxpayer per year.

Tentative Claim

To be eligible for the employer R&D tax credit, an employer would have to submit, in a form and manner as prescribed by the DoT, a tentative claim for which an R&D tax credit was sought to the DoT on or before March 15 after the calendar year ending with or within the tax year for which the employer intended to submit a claim for the credit on the employer's annual return. The tentative claim would have to include all the following information:

- The amount of qualifying R&D expenses incurred for which a credit were being claimed.
- If the credit were to be claimed by a business with more or less than 250 employees.
- If an additional credit were claimed for collaboration with a research university.

The DoT would have to review all tentative employer R&D claims submitted and if the amount of tentative claims submitted exceeded \$100.0 million the DoT would have to publish a notice on its website notifying claimants of the adjustment to the tentative claims for that calendar year.

Aggregate Credit Amount

The aggregate amount of credits allowed to be claimed by all employers and all taxpayers under House Bill 5100 based on qualifying R&D expenses incurred in a single calendar year could not exceed \$100 million. If the aggregate amount of employer R&D credits claimed and taxpayer R&D credits under House Bill 5100 exceeded \$100 million, the DoT would have to prorate the amount of credits allowed for each claimant as follows:

- If the aggregate amount of credits claimed by all employer with fewer than 250 employees qualifying under the bill and all taxpayer with fewer than 250 employees qualifying under House Bill 5100 (H-1) did not exceed \$25.0 million, the amount of credits claimed by each of those claimants could not be prorated; however, for an employer with 250 or more employees claiming a credit under the bill or taxpayers with 250 or more employees claiming a credit under House Bill 5100 (H-1), the amount of credits claimed would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of the remaining amount of credits allowed to be claimed under this provision and the aggregated amount of R&D credits.
- Except as otherwise provided, if the aggregate amount of credits claimed by all employers with fewer than 250 employees qualifying under the bill and all taxpayer with fewer than 250 employees qualifying under House Bill 5100 (H-1) exceeded \$25.0 million, the amount of credits claimed by each of those claimants would have to be prorated so that each

claimant's allowed credits equaled that claimant's pro rata share of \$25.0 million, and the amount of credits claimed by each employer with 250 or more employees claiming a credit under the bill or employers with 250 or more taxpayers claiming a credit under House Bill 5100 (H-1) would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of \$75.0 million.

- If the aggregate amount of credits claimed by all employers with fewer than 250 employees qualifying under the bill and all employers with fewer than 250 employees qualifying under House Bill 5100 (H-1) exceeded 25% of the aggregate amount of credits claimed by all employers under this provision and taxpayers under House Bill 5100 (H-1), then the proration described directly above would not apply, and the amount of credits claimed by each employer under this provision and taxpayer under House Bill 5100 (H-1) would have to be prorated so that each claimant's allowed credits equaled that claimant's pro rata share of \$100.0 million

A member of flow-through entity that submitted a claim for an employer R&D credit could not claim any portion of that credit. An employer could not assign or transfer all or any portion of an employer R&D tax credit. Under the bill, the employer R&D credit or any portion of the credit would not be assignable or transferable either by agreement or by operation of law.

A taxpayer would have to, in a form and manner as prescribed by the DoT, file a claim for a credit under these provisions with the annual return under Section 711 for the same tax year for which a tentative employer R&D credit was claimed. The employer R&D credit would have to be claimed after all allowable nonrefundable credits under Part 2. If the amount of the credits allowed under the bill exceeded the tax liability of the taxpayer for the tax year, that portion of the credit that exceeded the tax liability of the taxpayer for the tax year would have to be refunded.

House Bill 5102 (H-1)

Under the bill, by July 1 of each year, the DoT, in cooperation with the Board of Directors of the MSF, would have to submit to the Legislature, the Governor, and the Senate and House fiscal agencies an annual report concerning the operation and effectiveness of the R&D tax credits proposed by House Bills 5100 (H-1) and 5101 (H-1).

The report would have to include all the following:

- A brief assessment of the overall effectiveness of the R&D tax credits; the DoT could use the applicable provisions of the economic development incentive evaluation prepared under the Economic Development Incentive Evaluation Act to satisfy this provision.
- The number of authorized businesses filing tentative claims for an R&D tax credit for the immediately preceding calendar year.
- The name of each authorized business submitting claims for a R&D credit with an annual return and the amount of the credit allowed for the immediately preceding calendar year.
- The name of each authorized business claiming an additional credit for collaboration with a research university in the State and the amount of that additional credit for the immediately preceding calendar year.

The Board could delegate any actions to authorized employees, officers, and agents of the MSF, which could include employees of the Michigan Economic Development Corporation.

FISCAL IMPACT

The bills, which are not tie-barred to each other, would reduce General Fund and School Aid Fund revenue by approximately \$100.0 million per tax year. Because many taxpayers operate

under tax years that do not match the State's fiscal year, and some taxpayers file for extensions on their returns, the revenue reduction in any given fiscal year could differ from \$100.0 million.

The revenue loss would be primarily expected to reduce General Fund revenue; however, the credits claimed under section 717 could potentially reduce School Aid Fund revenue. House Bill 5101 (H-1) would allow credits against income tax withholding. Under current law, a portion of the revenue received under individual income tax withholding is directed to the School Aid Fund. (The actual portion is determined by statute and depends on the tax year and the tax rate in effect for that tax year. For tax year 2022, 23.8% of withholding was directed to the School Aid Fund.) In contrast, refundable credits are applied solely against the General Fund. However, under current law no refundable credits exist that apply to income tax withholding. As a result, it is unknown if the refundable credits provided for under Section 717 (House Bill 5101 (H-1)) would be split between the General Fund and the School Aid Fund or applied entirely against the General Fund.

The bills would increase administrative costs to the MSF in the form of additional staff time and IT to develop and oversee the tax credit program and report to the Governor and Legislature. These costs are likely to be covered with the administrative fee up to 5% of the credit amount. If the MSF put the administrative fee at 5%, that would amount to \$5.0 million annually, which should be sufficient to cover the administration costs of the tax credit program.

The bills would increase administrative costs to the DoT to report to the Governor and Legislature. The final cost to the DoT would depend on how much of the reporting costs are supported by the DoT or the MSF.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.