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BILL ANALYSIS



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House Bill 5845 (Substitute H-1 as passed by the House)
Sponsor: Representative Bill Huizenga
House Committee: Commerce
Senate Committee: Commerce and Tourism

Date Completed: 3-17-08

CONTENT

The bill would amend the Income Tax Act to do both of the following:

- Allow an income tax deduction for tax years beginning after December 31, 2007, and before October 1, 2015, for all or part of the gain from an equity investment of at least \$25,000 in an "eligible production company" or a "film and digital media private equity fund" that produced or financed a "state certified qualified production", if an amount were reinvested within two years.**
- Revise a provision that allows a deduction for all or part of the gain from an equity investment of at least \$100,000 in a "qualified business" that is reinvested within one year, by reducing the minimum investment to \$25,000, allowing reinvestment within two years, and extending the deadline for making a deductible investment to October 1, 2015.**

Investment in Eligible Production Company

The bill would allow a deduction from a taxpayer's taxable income, for tax years beginning after December 31, 2007, and before October 1, 2015, to the extent included in adjusted gross income, for all or a portion of the gain realized from an initial equity investment of at least \$25,000 made by the taxpayer in an eligible production company or a film and digital media private equity fund that produced or financed a State certified qualified production.

For the taxpayer to qualify for the deduction, an amount equal to the sum of the taxpayer's basis in the investment plus the gain, or a portion of that amount, would have to be reinvested in an equity investment in an eligible production company or a film and digital media private equity fund that produced or financed another State certified qualified production within two years after the sale or disposition of the investment in the eligible production company or private equity fund.

If the amount of the subsequent investment were less than the sum of the taxpayer's basis from the prior equity investment plus the gain from that investment, the amount of the deduction would have to be reduced by the difference between those amounts.

"Eligible production company" and "state certified qualified production" would mean those terms as defined in Section 455 of the Michigan Business Tax Act, proposed by House Bill 5841. "Film and digital media private equity fund" would mean that term as defined in Section 88d of the Michigan Strategic Fund Act, which House Bill 5848 would amend.

(Under House Bill 5841 (H-1), "eligible production company" would mean an entity in the business of producing qualified productions, but would not include an entity that was more than 30% owned, affiliated, or controlled by an entity or individual who was in default on a loan made or guaranteed by this State or by any other state.

"State certified qualified production" would mean a single media or multimedia entertainment content created in whole or in part in Michigan for distribution or exhibition to the general public in two or more states by any means and media in any digital media format, film, or video tape, including a motion picture, a documentary, a television series, a television miniseries, a television special, interstitial television programming, long-form television, interactive television, music videos, interactive games, video games, commercials, internet programming, an internet video, a sound recording, a video, digital animation, or an interactive website. The term also would include any trailer, pilot, video teaser, or demo created primarily to stimulate the sale, marketing, promotion, or exploitation of future investment in a production. State certified qualified production would not include a production for which records must be maintained under 18 USC 2257 (which requires anyone who produces a film, videotape, or other matter containing visual depictions of actual sexual conduct, that is produced for interstate or foreign shipment or transportation, to create and maintain individually identifiable records pertaining to every performer portrayed in the visual depiction). The term also would not include any of the following:

- A production that includes obscene matter or an obscene performance.
- A production that primarily consists of televised news or current events, a live sporting event, or political advertising.
- A radio program.
- A weather show, talk show, or game show.
- A financial market report.
- A production that primarily markets a product or service other than a State certified qualified production.
- An awards show or other gala event production.
- A production with the primary purpose of fund-raising.
- A production that primarily is for employee training or in-house corporate advertising or other similar production.

Under House Bill 5848 (H-1), "film and digital media private equity fund" would mean any limited partnership, limited liability company, or corporation organized and operating in the United States that has as its primary business activity the investment of funds in return for equity in qualified productions; holds out the prospect for capital appreciation from the investments; and accepts investments only from accredited investors.)

Equity Investment

Under the Act, for tax years beginning after December 31, 2006, a taxpayer may deduct, to the extent included in adjusted gross income, all or a portion of the gain realized from an initial equity investment of at least \$100,000 made by the taxpayer before December 31, 2009, in a qualified business, if an amount equal to the sum of the taxpayer's basis in the investment plus the gain, or a portion of that amount, is reinvested in an equity investment in a qualified business within one year after the sale or disposition of the investment in the qualified business. Under the bill, the deduction would be allowed if the minimum initial equity investment were \$25,000, rather than \$100,000; the reinvestment occurred within two years, rather than within one year; and the initial equity investment would have to be made before October 1, 2015.

("Qualified business" means a business that complies with all of the following:

- Is a seed or early stage business as defined in the Michigan Early Stage Venture Investment Act.
- Has its headquarters, is domiciled, or has a majority of its employees working a majority of their time in Michigan.
- Has a preinvestment valuation of less than \$10 million.
- Has existed less than five years.
- Is engaged only in competitive edge technology.
- Is certified by the Michigan Strategic Fund as meeting these requirements at the time of each proposed investment.

The requirement that a qualified business have been in existence less than five years does not apply to a business whose business activity is derived from research at an institution of higher education located in Michigan or an organization that is exempt from Federal taxes under Section 501(c)(3) of the Internal Revenue Code and is located in Michigan.)

MCL 206.30

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bill would decrease State General Fund revenue by an unknown and likely negligible amount, depending on the characteristics of specific affected taxpayers and the rate of return earned on eligible investments. As of 2007, only five firms had been approved under the existing language in the Act and none of them had generated a gain that could taxable (and thus eligible for the deduction if reinvested). As a result, the existing provision has yet to result in any revenue loss to the State. Lowering the threshold from \$100,000 to \$25,000 under the bill would increase the investments that could be considered under the provision, as would extending the time horizon for reinvestment from one year to two years, and extending to 2015 the period for eligible investments under current law. However, the changes would not affect the underlying before-tax rates of return on the investments. Investments that have not made a gain would not be affected by the bill. Given the time frames involved in the bill and the short-term potential for gains, the bill is not expected to have any meaningful fiscal impact in the near future.

While not tie-barred to other bills affecting similar taxpayers, the bill's provisions regarding eligible production companies would not preclude the investment expenditures from being eligible for credits under the other bills, or other provisions of the individual income tax or the Michigan business tax.

Fiscal Analyst: David Zin

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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.