

RESEARCH AND DEVELOPMENT TAX CREDIT

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<http://www.house.mi.gov/hfa>

House Bill 5099 as introduced
Sponsor: Rep. Rachel Hood

Analysis available at
<http://www.legislature.mi.gov>

House Bill 5100 as introduced
Sponsor: Rep. Jasper Martus

House Bill 5101 as introduced
Sponsor: Rep. Julie M. Rogers

House Bill 5102 as introduced
Sponsor: Rep. Ranjeev Puri

Committee: Economic Development and Small Business
Complete to 10-17-23

SUMMARY:

House Bills 5099 to 5102 would create a state-level tax credit to foster research and development (R&D) in Michigan. The bills are tie-barred together, which means that none of the bills can take effect unless all are enacted.

House Bill 5099 would add a new chapter to the Michigan Strategic Fund Act to authorize the Michigan Strategic Fund (MSF) to create and operate a research and development tax credit for certain *authorized businesses*. The MSF would determine the amount and duration of the credit in consideration of the applicable amounts and limitations established under the Income Tax Act,¹ although it could not award more than \$100.0 million in credits in a single calendar year, and at least \$25.0 million of that annual cap would be reserved for eligible businesses with fewer than 250 employees (to the extent that those businesses apply for the credit).

Authorized business would mean a business that has met the requirements described below and with which the MSF has entered into a written agreement for a research and development tax credit.

Eligible businesses

To be eligible for the credit, a business would have to propose to increase *research and development spending* in Michigan through projects with the potential for significant technological advancements, job creation, and positive economic impact. A business with at least 250 employees would have to propose to increase R&D spending by at least \$500,000 per year above its *base amount*, and a business with fewer than 250 employees would have to propose an increase of at least \$100,000 per year above its base amount.

¹ House Bills 5100, 5101, and 5102, described below, would provide these limitations.

Research and development spending would mean spending for qualified research expenses (QREs), as that term is defined under federal law.² Generally, it would mean spending for technological research, including employee wages, contract expenses, and supply costs.

Base amount would mean the average annual amount of research and development expenses incurred in Michigan by the eligible business during the three tax years preceding the first tax year for which a research and development credit is claimed. (Eligible businesses with no prior R&D spending in Michigan would have a base amount of zero.) The base amount would remain unchanged for the duration of the tax credit.

To determine whether a business's R&D expenses are incurred in Michigan, the MSF would have to consider the place where the **qualified research services** are performed or the **qualified research** is conducted, the residence or business location of those performing the qualified research services or conducting the qualified research, and the place where **qualified research supplies** are consumed. The MSF could also consider additional factors as it deems relevant to determining where the research occurred.

Qualified research services would mean services consisting of engaging in qualified research or engaging in the direct supervision or direct support of qualified research activities.

Qualified research would mean research to which the following applies:

- The research expenditures may be treated as expenses.
- It is undertaken for the purpose of discovering information.
- It is technological in nature.
- The application of the research is intended to be useful in the development of a new or improved business component.
- Substantially all of the research activities constitute elements of a process of experimentation for a new or improved function, performance, reliability, or quality.

Qualified research would *not* include research after commercial production, the adaptation or duplication of existing business components, surveys and studies, computer software (in most circumstances), foreign research, social sciences, or research funded by another person or entity. It also would not include research relating to style, taste, cosmetic, or seasonal design factors.

Qualified research supplies would mean tangible property other than land, improvements to land, or "property of a character subject to the allowance for depreciation" that is used for qualified research.

² For a full description of qualified research expenses, see: <https://www.irs.gov/businesses/audit-techniques-guide-credit-for-increasing-research-activities-ie-research-tax-credit-irc-ss-41-qualified-research-expenses>. See also the definition of **qualified research**.

Application and written agreement

The MSF would be responsible for establishing an application process for eligible businesses to receive the tax credit and would have to publish a detailed description of the application, approval, compliance, and certification process for the program on its website. (The bill would allow the MSF to request additional information beyond what is included in an application, if necessary.)

If an eligible business proposes to invest in and maintain a sufficient level of R&D spending and development spending in Michigan, the investment plans are economically sound, and the investment would increase opportunities for Michigan residents and strengthen the state's economy, the MSF could enter into a binding written agreement with the business to authorize the tax credit. A written agreement would have to include the following information:

- A description of the location that is the subject of the agreement.
- The conditions under which the business will be designated as an authorized business.
- The duration of the agreement and the amount of the R&D tax credit that can be claimed each tax year for the duration of the agreement.
- The calculation of the base amount.
- The business's acknowledgment that a violation of the agreement may result in a revocation of the authorized business designation or the loss or reduction of the tax credit.
- The business's acknowledgment that a misrepresentation in the application may result in the revocation of the authorized business designation and the eligibility to claim the credit.

Once the agreement is executed, the business would be designated as an authorized business and eligible for the credit. The MSF could charge authorized businesses an administrative fee of up to 5% of the amount of the credit.

For each year an authorized business is eligible for the R&D tax credit, the MSF would have to provide the business with a certificate that includes the following:

- A statement that the business is an authorized business.
- The amount of the tax credit awarded under the Income Tax Act and the designated tax year.
- The business's federal employer identification number or Michigan Treasury number.

If there is a proposed reorganization, merger, or other ownership change for an authorized business, the MSF would have to approve the assignment or transfer of the written agreement in order for reimbursement under the tax credit program to continue.

An eligible business could apply for a new credit after its written agreement expires, but the base amount would have to be recalculated and a new written agreement would have to be executed.³

The Michigan Department of Treasury would receive a copy of each written agreement and each certificate.

³ This provision would not apply to an agreement that is terminated due to a business's breach of the agreement.

Reports

Authorized businesses would have to file all required returns and reports and would have to provide any other information that is reasonably requested by the MSF or the Department of Treasury.

The MSF would have to include the name of each authorized business that received an R&D tax credit, the amount and duration of each R&D tax credit, and a description of the business's R&D investment that is the basis for the credit in its annual report.

MCL 125.2009 (amended); MCL 125.2090t et seq. (proposed)

House Bill 5100 would amend the Income Tax Act to provide an income tax credit for businesses with *at least 250 employees* for certain expenditures incurred in Michigan for projects with the potential for significant technological advancements, job creation, and positive economic impact. The bill would add two sections to the act—one to Part 1, which deals with the individual income tax, and one to Part 2, which addresses the corporate income tax. The credits would be available for five years under a single agreement, beginning January 1, 2024, and would be claimed after all other tax credits under Part 1 or Part 2, as applicable.

The Michigan Strategic Fund could approve a credit against the individual or corporate income tax for an authorized business with at least 250 employees for 10% of its research and development expenses that exceed the base amount (as defined by House Bill 5099).

A single applicant could not receive a credit of more than \$2.0 million per tax year or \$10.0 million over five tax years, and an applicant could not claim a credit for more than five tax years under the same written agreement.

The total amount of credits awarded by the MSF in a calendar year could not exceed \$100.0 million, and at least \$25.0 million of that cap would have to be awarded to eligible businesses with fewer than 250 employees (to the extent that those businesses apply for the credit).⁴

If the MSF approves an application, it would have to provide applicants with the certificate described in House Bill 5099, and an applicant that claims a credit would have to submit a copy of the certificate with their annual tax return.

A qualified taxpayer who is a member of a flow-through entity could claim a credit against the member's tax liability based on the member's distributive share of business income reported from the flow-through entity or an alternative method approved by the Department of Treasury.

If the amount of the allowed credit exceeded the tax liability of an applicant for the tax year, that portion of the credit that exceeded the tax liability would not be refunded but *could* be carried forward to offset tax liability under the Income Tax Act for up to five years or until used up, whichever occurred first.

Proposed MCL 206.277 and 206. 677

⁴ House Bill 5101, described below, would provide for a credit for businesses with fewer than 250 employees.

House Bill 5101 would amend the Income Tax Act to provide an individual and corporate income tax credit for businesses with *fewer than 250 employees* for certain expenditures incurred in Michigan for projects with the potential for significant technological advancements, job creation, and positive economic impact. The credits would be available for seven years under a single agreement, beginning January 1, 2024, and would be claimed after all other tax credits under Part 1 or Part 2, as applicable.

The Michigan Strategic Fund could approve a credit against the individual or corporate income tax for an authorized business with fewer than 250 employees for 15% of its research and development expenses that exceed the base amount.

The amount of credits that could be approved would be subject to the \$100.0 million annual cap provided for by House Bill 5099, but the MSF would have to award at least \$25.0 million to businesses with fewer than 250 employees who apply for the credit under House Bill 5101 (to the extent that those businesses apply for the credit).

A single applicant could not receive a credit of more than \$250,000 per tax year or \$1.0 million over seven tax years, and an applicant could not claim a credit for more than seven tax years under the same written agreement.

If the MSF approves an application, it would have to provide applicants with the certificate described in House Bill 5099, and an applicant that claims a credit would have to submit a copy of the certificate with their annual tax return.

A qualified taxpayer who is a member of a flow-through entity could claim a credit against the member's tax liability based on the member's distributive share of business income reported from the flow-through entity or an alternative method approved by the Department of Treasury.

If the amount of the allowed credit exceeded the tax liability of an applicant for the tax year, that portion of the credit that exceeded the tax liability would be refunded.

Proposed MCL 206.277a and 206.677a

House Bill 5102 would amend the Income Tax Act to provide an additional individual and corporate income tax credit for research and development projects that collaborate with Michigan's research universities. The credits would be available for eligible businesses of any size beginning January 1, 2024, and would be claimed after all other tax credits under Part 1 or Part 2, as applicable.

The Michigan Strategic Fund could approve a credit against the individual or corporate income tax for a business claiming an R&D tax credit that has a demonstrated plan to collaborate with a research university for an additional 5% of its research and development expenses that exceed the base amount. The additional credit would be subject to the \$100.0 million annual cap and the requirement that at least \$25.0 million of that cap be reserved for businesses with fewer than 250 employees.

If the additional credit is claimed by a business with at least 250 employees, it could be claimed for up to five tax years and could not exceed \$1.0 million over the five tax years under a single written agreement. If the credit is claimed by a business with fewer than 250 employees, it

could be claimed for up to seven years and could not exceed \$1.0 over the seven tax years under a single written agreement.

If the MSF approves an application, it would have to provide applicants with an additional certificate that includes the following:

- A statement that the applicant is claiming a research and development tax credit under the Income Tax Act.
- The amount of the additional credit awarded under the act and the designated tax year.
- The applicant's federal employer identification number or Michigan Treasury number.

An applicant that claims a credit would have to submit a copy of the certificate with their annual tax return.

A qualified taxpayer who is a member of a flow-through entity could claim a credit against the member's tax liability based on the member's distributive share of business income reported from the flow-through entity or an alternative method approved by the Department of Treasury.

For businesses with at least 250 employees, if the amount of the allowed credit exceeded the tax liability of an applicant for the tax year, that portion of the credit that exceeded the tax liability would not be refunded but *could* be carried forward to offset tax liability under the Income Tax Act for up to five years or until used up, whichever occurred first. For businesses with fewer than 250 employees, the portion of the credit that exceeded the tax liability would be refunded.

Proposed MCL 206.277b and 206.677b

BACKGROUND:

An R&D tax credit is available at the federal level under section 41 of the Internal Revenue Code.⁵ As of June 2023, 36 states reportedly offer an R&D tax credit to offset state tax liability.⁶

FISCAL IMPACT:

As written, the bills would be expected to reduce state revenue by approximately \$100 million annually for tax years beginning after January 1, 2024.

Although the bills state that the Michigan Strategic Fund may not authorize more than \$100 million of income tax credits in any single calendar year, it is possible that the actual revenue impact of the credits could be more than or less than \$100 million in a given year depending on when the credits are actually claimed.

Any revenue loss would come from the general fund.

In addition, House Bill 5099 would increase costs to the Michigan Strategic Fund by an indeterminate amount. Under the provisions of the bill, MSF would be required to report

⁵ See: [USCODE-2021-title26-subtitleA-chap1-subchapA-partIV-subpartD-sec41.pdf \(govinfo.gov\)](https://www.govinfo.gov/uscodes/title26/subtitleA/chapter1/subchapterA/partIV/subpartD/section41)

⁶ <https://www.kbkg.com/research-tax-credits/research-development-tax-credit-state-benefits>.

specific information to the governor and the legislature on each research and development tax credit awarded. The bill also requires the MSF to create and develop a research and development tax credit program, including a detailed application, approval, compliance, and certification process. While the bill allows the MSF to charge and collect fees for administrative expenses, it is unclear whether these fees would create enough revenue to support the additional administrative costs of the new program to the MSF. The bill would increase costs to the Department of Treasury by an indeterminate amount for additional administration expenses.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations and does not constitute an official statement of legislative intent.