

LEGAL ALERT

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INCOME TAX ACT AMENDED CREATES NEW DEDUCTION IN 4 KEY TARGETED AREAS

By: Stephanie A. Neal, Attorney

Recent amendments to the Michigan Income Tax Act create a new deduction for taxpayer investments in four key targeted areas. Taxpayers now will be able to deduct, to the extent included in adjusted gross income, all or a portion of gain realized from an initial equity investment of a least \$100,000 made in a *qualified business*, if the investment plus the gain, or a portion of it, are reinvested in an equity investment in a qualified seed or early-stage business within one year after the initial gain is realized.

Qualified Business. A *qualified business* generally is a seed or early stage venture that has its headquarters in Michigan, is domiciled in this state or has a majority of its employees working a majority of their time in this state; has a pre-investment valuation of less than \$10 million; has been in existence less than five years¹, is engaged in *competitive edge technology* and is certified by the Michigan strategic fund.

Businesses interested in taking advantage of this new income tax deduction should start thinking now of what evidentiary records it might maintain as proof to substantiate such a deduction. In order to be able to claim this deduction, accurate records must be maintained to verify the initial investment in the business and to document the fact that the business is a 'qualified business' as defined by the

¹ There is an exception to the rule that the business must be in existence less than 5 years for business activity derived from research at an institution of higher education located within this state or an organization exempt from federal taxation under Section 501(C)(3) of the Internal Revenue Code and that is located within this state.

Act. For new entities being formed, documentation requirements can be incorporated into organizational documents.

Four Key Targeted Areas. To be a "qualified business" the taxpayer must be engaged only in *competitive edge technology*. The amendment to the Michigan Income Tax Act identifies four key areas as "competitive edge technology" eligible for the new income tax deduction. The targeted areas include:

- Advanced automotive, manufacturing, and materials technology
- Alternative energy technology
- Homeland security and defense technology
- Life sciences technology

The amendment defines each competitive edge technology and provides some examples; the following list is not exhaustive.

Advanced Automotive, Manufacturing, & Materials Technology. Technology involving i) materials with engineered with properties created through the development of specialized process and synthesis technology, ii) nanotechnology, iii) microelectro-mechanical systems, iv) improvements to vehicle safety, vehicle performance, vehicle production, or environmental impact to vehicle equipment and component parts, v) any technology that involves an alternative energy vehicle or its components, vi) any new technology, device or system that enhances or improves the manufacturing process of wood, timber or

agricultural-based products, or vii) advanced computing technology.

Alternative Energy. Applied research or commercialization of new or next generation technology in i) alternative energy technology, ii) devices or systems designed and used solely for the purpose of generating energy from agricultural crops, residue and waste generated from the production and processing of agricultural products, animal wastes, or food processing wastes; iii) new technology, product or system that permits the utilization of biomass for the production of specialty, commodity, or foundational chemicals or of novel or economical commodity materials through the application of biotechnology that minimizes, complements, or replaces reliance on petroleum for the production, iv) electronic device technology.

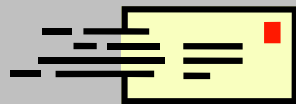
Homeland Security. Defensive technology that assists in the assessment of threats or damage to the general population and critical infrastructure such as sensors, equipment for communications, identification and authentication, screening, surveillance, tracking and data analysis. Aviation technology such as avionics, airframe design, sensors, and early warning systems.

Life Sciences. Science for the examination or understanding of life or life processes, such as Bioengineering, Biomedical Engineering,

Genomics, Proteomics, Molecular and Chemical Ecology, and Biotechnology including any technology that uses living organisms, cells, macromolecules, microorganisms, or substances from living organisms to make or modify a product for useful purposes. "Life sciences" excludes activities prohibited under the public health code and stem cell research with human embryonic tissue. Life science technology is intended to improve human health or the overall quality of human life such as equipment for drug or gene therapies, biosensors, testing, medical devices or instrumentation with a therapeutic or diagnostic value, a pharmaceutical or other product that requires U.S. food and drug administration approval or registration prior to its introduction

Effective dates. This deduction may be claimed for tax years beginning on or after January 1, 2007; and the initial equity investment must be made before December 31, 2009.

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