



**House  
Legislative  
Analysis  
Section**

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## INTEREST ON EMPLOYEE LOANS

House Bill 5100 as introduced  
First Analysis (11-30-95)

Sponsor: Rep. Ken Sikkema  
Committee: Commerce

### ***THE APPARENT PROBLEM:***

The Business Corporation Act currently allows a corporation to lend money to, guarantee an obligation of, or otherwise assist an officer or employee of the firm or one of its subsidiaries if the corporate board determined that doing so would benefit the firm. In recent years, more publicly-held corporations offer their employees loans to purchase shares from the company as a means to motivate them to help improve the company's performance. However, for a company in Michigan to do this at present it could not charge a rate of interest exceeding seven percent, as the act does not specify what interest rate applies to such loans and, thus, they are subject to the cap specified under the general usury act. This presents an occasional problem for companies due to a rule established by the federal Internal Revenue Service regarding the threshold at which an employee "benefit" is considered taxable. The IRS determines what is known as the "applicable federal rate" (AFR) for long term loans, which refers to the lowest interest rate that may be charged without imputing income to the borrower, on a monthly basis. (This rate is closely tied to the prime rate.) If the AFR is set at a rate above seven percent, where it has hovered in recent months, loans issued by Michigan companies for the sake of purchasing company shares would be considered taxable income to the employees. To resolve this problem, legislation has been proposed that would cap the rate that could be charged on such loans to that permitted under the criminal usury act, currently 25 percent.

### ***THE CONTENT OF THE BILL:***

The bill would amend the Business Corporation Act to specify that a loan issued to an officer or employee of the firm or one of its subsidiaries for its benefit could be made at any rate of interest not exceeding the rate of interest allowed under Public Act 259 of 1968 (that is, no more than 25 percent annual interest).

MCL 450.1548

### ***FISCAL IMPLICATIONS:***

The Corporations and Securities Bureau, within the Department of Commerce, says the bill would not affect state or local budget expenditures. (11-29-95)

### ***ARGUMENTS:***

#### ***For:***

The bill simply would make it possible for a corporation regulated under the Business Corporation Act to loan money to an officer or employee of the company so that he or she can purchase shares of the company without the loan being subject to federal income taxes. This type of benefit has become more common among companies, especially those which are publicly held, that hope to motivate their employees to feel as if they have more of a stake in the company's performance. However, because such loans currently cannot be made at a rate exceeding seven percent interest under the act, they are considered taxable income by the IRS if the applicable federal rate, which is calculated monthly, exceeds seven percent--as it has at times over the last year or so when the prime rate has hovered near nine percent. By raising the cap on the rate that could be charged on such loans to 25 percent, the bill would give companies the ability to make these loans now at a rate above the AFR so they could be excluded from federal income taxes, but would also give them leeway if interest rates rise in the future.

### ***POSITIONS:***

The Department of Commerce has no position on the bill. (11-29-95)

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House Bill 5100 (11-30-95)