



**CORPORATE FRANCHISE TAX
INDIVIDUAL INCOME TAX
R&D Credit: Alternate Simplified
Credit Option with Two Tier Credits**

February 22, 2022

Preliminary Estimates

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 3316 (Robbins) / S.F.2970 (Coleman)

	Fund Impact			
	<u>F.Y. 2022</u>	<u>F.Y. 2023</u>	<u>F.Y. 2024</u>	<u>F.Y. 2025</u>
		(000's)		
Corporate Franchise Tax	\$0	(\$18,000)	(\$14,800)	(\$16,400)
Individual Income Tax	\$0	(\$6,100)	(\$6,400)	(\$6,700)
General Fund	\$0	(\$24,100)	(\$21,200)	(\$23,100)

Effective beginning in tax year 2022.

EXPLANATION OF THE BILL

Current Law: Minnesota law requires the research tax credit to be computed using a method similar to the regular method under federal law. Current-year research and development (R&D) expenditures conducted in Minnesota qualify for the tax credit if they are greater than the base amount.

The base amount is the larger of the following two calculations:

- (1) 50% of current-year Minnesota research and development expenditures, or
- (2) Average Minnesota gross receipts over the prior four years multiplied by the fixed-base percentage*.

*The fixed-base percentage is R&D during 1984 through 1988 divided by total Minnesota gross receipts for the same years. The fixed-base percentage is capped at 16%.

The base amount used by the overwhelming majority of taxpayers is 50% of current-year Minnesota R&D expenditures. As a result, the amount of dollars eligible for credit, “creditable dollars” is 50% of current-year Minnesota R&D expenditures (i.e., current-year Minnesota R&D minus the base amount of 50% of current-year Minnesota R&D.)

The tax credit equals creditable dollars times the applicable credit rates. The first-tier tax credit rate of 10% applies to the first \$2 million of creditable dollars. A second-tier tax credit rate of 4% applies to creditable dollars greater than \$2 million.

EXPLANATION OF THE BILL (Cont.)

Proposed Law: The bill allows another option to compute the research credit. A similar option is available under federal law, called the alternative simplified credit (ASC.) Under this option, current-year Minnesota R&D expenditures must be greater than a single calculation of a base amount instead of the higher of two base amount calculations.

The base amount under the ASC method is 50% of average Minnesota R&D expenditures during the past three years. The difference between current-year R&D and the ASC base amount equals creditable dollars.

As with the regular method under current law, the first \$2 million of creditable dollars is subject to a 10% tax credit rate. Any amount greater than \$2 million is subject to a 4% tax credit rate. Unlike federal law, this bill has no reduced tax credit rate for start-up companies.

If the amount of R&D is increasing, the base amount will be lower under the ASC method than under current law. A lower base amount yields more creditable dollars because creditable dollars is the difference between current-year Minnesota R&D expenditures and the base amount.

REVENUE ANALYSIS DETAIL

- A database of schedule RD information from corporate taxpayers for tax years 2009-2012 was used to estimate this proposal.
- Overall, the total creditable dollars under the ASC option are 24% higher than those under current law.
- Because the credit is nonrefundable, creditable dollars are assumed to grow at 4.3% per year.
- Results from the analysis of the database of schedule RD information show that about 50% of the increase in tax credit dollars would be used to reduce current-year tax liabilities. The other 50% of the increase in tax credit dollars would be carried forward to reduce tax liability in future years.
- The revenue impact of the carryover from additional credits created by the ASC option will be delayed. In fiscal year 2025 only a small portion of the revenue loss is from the use of carryover credits. In fiscal years in and after fiscal year 2026, carryforwards will substantially increase the revenue loss.
- Due to a retroactive effective date, all the tax year 2022 revenue loss is allocated to FY 2023. Losses from other tax years are allocated 30% / 70% to fiscal years.

Number of Taxpayers: Analysis of the R&D tax credit assumes that most taxpayers would choose the ASC method because the base amount is lower than under current law.

Minnesota Department of Revenue
Tax Research Division
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