

VARIOUS TAXES
Changes to R & D Tax Credit
Tax Credit for Investments
Sales Tax Exemption

March 19, 2001

	Yes	No
Separate Official Fiscal Note Requested		X
Fiscal Impact		
DOR Administrative Costs/Savings	X	

Department of Revenue

Analysis of H.F. 503 (Pawlenty)/ S.F. 1532 (S. P. Kelley)

PRELIMINARY ANALYSIS

	Revenue Gain or (Loss)			
	<u>F.Y. 2002</u>	<u>F.Y. 2003</u>	<u>F.Y. 2004</u>	<u>FY2005</u>
			(000's)	
Sales Tax	(\$6,700)	(\$7,500)	(\$8,400)	(\$9,400)
Research Credit				
Individual Income Tax	(\$1,200)	(\$1,000)	(\$1,200)	(\$1,300)
Corporate Franchise Tax	(\$20,700)	(\$17,900)	(\$20,100)	(\$22,600)
Investment Credit		---(Unknown)---		
General Fund Total	(\$28,600)	(\$26,400)	(\$29,700)	(\$33,300)

Sales tax effective for R & D related purchases after June 30, 2001.

R & D credit changes effective for tax years beginning after December 31, 2000.

Credit for investments in selected industries effective for investments made during calendar year 2000.

EXPLANATION OF THE BILL

Current Law: For the sales and use tax, purchases of equipment for use in research and development by a business that produces a product for sale at retail qualify for the capital equipment exemption. In addition, items used or consumed for research and development (along with quality control, testing, and design) activities that are considered part of the production process are exempt from the sales tax. However, the exemptions do not cover all purchases of tangible personal property and services associated with R & D expenditures because some R & D purchases are not capital in nature, i.e., supplies, or they cannot be tied to the sale of a product sold by a company. The capital equipment exemption is administered as a refund.

Corporations are allowed to claim a research and development credit. The credit is 5% of the first \$2 million of the current-year expenditures over the base amount and 2.5% of the amount over \$2 million. The R & D credit is allowed only to C corporations.

There is no provision for a tax credit for investments in selected industries.

Proposed Law: All purchases of tangible personal property and services associated with R & D expenditures would be exempt from the sales tax. Capital equipment used for R & D would qualify for an up-front exemption.

Both individuals and corporations would be allowed to claim a research and development tax credit. The credit would be 5% of the current-year expenditures over the base amount.

Individuals would be allowed to claim a tax credit equal to 25% of the investments in a qualified business. A qualified business has less than \$5 million in sales and is primarily engaged in manufacturing, processing, warehousing, wholesaling, research and development or a service-related industry. No credit is allowed if a broker's fee or commission is paid for the purchase of equity securities or subordinated debt in the business.

REVENUE ANALYSIS DETAIL

Sales and Use Tax

- Filed 1998 corporate franchise tax R & D data was used to compute the total R & D expenditures.
- A small portion of total R & D expenditures is assumed to be purchases of tangible personal property and services currently subject to the sales tax.
- The average growth in R & D credits claimed during the past years is used to project future revenue losses.

Research Credit - Individual Income Tax.

- It is assumed that non-corporate taxpayers will claim R & D credits equal to the portion of total federal R & D credits now claimed by non-corporate taxpayers, i.e., 1.8%.
- The average growth in R & D credits claimed during the past years is used to project future revenue losses.
- The FY 2002 estimate was increased by 30% to reflect the January 1, 2001, effective date.

Research Credit - Corporate Franchise Tax

- The revenue estimate is based on data from returns received in calendar year 1998.
- The estimate assumes that filed 1998 data represents collections in fiscal year 1998.
- A program was run against the data to calculate the impact of changing the credit rate to 5%.
- The average growth in R & D credits claimed during the past years is used to project future revenue losses.
- The FY 2002 estimate was increased by 30% to reflect the January 1, 2001, effective date.

Investment Credit

- It is unknown how many dollars on investments would qualify for the 25% tax credit.

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Number of Taxpayers Affected: About 100 companies would benefit from the research credit changes. Between 250 to 300 companies would benefit from the sales tax exemption.

ADMINISTRATIVE/OPERATIONAL IMPACT

Because the department is currently formalizing a reengineered process for the income tax, the operational impact of this provision cannot be precisely estimated. However, there will be some additional costs associated with the expansion to the current corporate tax credit, and the two new individual income tax credits.

Source: Minnesota Department of Revenue
Tax Research Division
<http://www.taxes.state.mn.us/polic.html#analyses>

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