

**CORPORATE FRANCHISE TAX
INDIVIDUAL INCOME TAX
R&D Credit: Alternate Simplified
Credit Option**

February 19, 2019

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 996 (Senjem)

	Fund Impact			
	F.Y. 2020	F.Y. 2021	F.Y. 2022	F.Y. 2023
	(000's)			
Corporate Franchise Tax	(\$20,800)	(\$16,500)	(\$18,800)	(\$25,400)
Individual Income Tax	(\$200)	(\$200)	(\$300)	(\$300)
General Fund	(\$21,000)	(\$16,700)	(\$19,100)	(\$25,700)

Effective beginning tax year 2019.

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 (capped at 16%) equals total Minnesota R&D expenditures for the years 1984 through 1988 divided by total Minnesota gross receipts for the same years.

For the overwhelming majority of taxpayers, the larger base amount is 50% of current-year Minnesota R&D expenditures. For these taxpayers, eligible expenditures for the tax credit equal 50% of current-year Minnesota R&D expenditures (i.e., current-year Minnesota R&D minus the base amount.) The tax credit is the product of eligible expenditures, “creditable dollars,” times the tax credit rates. A 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

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, creditable dollars equal current-year Minnesota R&D expenditures minus 50% of average Minnesota R&D expenditures during the past three years. A single tax credit rate of 6% would apply to the ASC calculation of creditable dollars.

If the taxpayer revokes the election to use the ASC option, the taxpayer cannot elect to use the ASC option for the next five years.

Unlike federal law, there is no reduced tax credit rate for start-up companies.

REVENUE ANALYSIS DETAIL

Corporate Franchise Tax

- A database of schedule R&D information from corporate taxpayers for tax years 2009-2012 was used to estimate this proposal.
- The ASC option changes both the amount of creditable dollars and the tax credit rates applied to those dollars.
- Overall, the total creditable dollars under the ASC option are 24% higher than those under current law. For some taxpayers their creditable dollars would be less than those under current law.
- Few taxpayers having 100% of their creditable dollar subject to the 10% first tier credit under current law would have a higher tax credit under the ASC option. These taxpayers would need to increase their creditable dollars by more than 67% to offset the impact of the lower 6% ASC tax credit rate.
- Under current law and with an assumption of all things being equal, the average effective tax credit tax rate falls below 6% when the creditable dollars are \$6.0 million or higher. Under this assumption, taxpayers with more than \$6.0 million in creditable dollars under current law will generally switch to the ASC option. For taxpayers with creditable dollars below \$6.0 million, it takes a large increase in creditable dollars, due to a large decrease in the base amount, to offset the effects of the lower 6% ASC tax credit rate.
- For about 2/3 of taxpayers, the ASC option produces a smaller tax credit than under current law. These taxpayers accounted for 15% of all current-year R&D expenditures.
- For about 1/3 of taxpayers, the ASC option produces a larger tax credit than under current law. These taxpayers accounted for 85% of all current-year R&D expenditures. For these taxpayers the overall ratio of tax credit to current-year R&D expenditure increases by 75%, from 2.0% to 3.5%.
- Because the credit continues to be non-refundable, research credit dollars are assumed to grow at 3% per year.
- Results from the analysis of database of schedule R&D information show that about 40% of the increase in tax credit dollars would be used to reduce current-year tax liabilities. The other 60% 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, 2022 only a small portion of the revenue loss is from the use of carryover credits. In fiscal years in and after fiscal year 2023, carryforwards will substantially increase the revenue loss.
- Due to a retroactive effective date, all of the tax year 2019 revenue loss is allocated to FY 2020. Losses from other tax years are allocated 30/70 to fiscal years.

REVENUE ANALYSIS DETAIL (Cont.)

Individual Income Tax

- It is assumed that very few individuals would choose the ASC option to calculate their R&D credit because a relatively small share of their creditable dollars is subject to the second-tier tax credit rate.
- Because the credit continues to be non-refundable, the total research credit amounts are assumed to grow at 3% per year.
- Tax year losses are allocated to the following fiscal year.

Number of Taxpayers: In the beginning, the law change will increase the R&D credit for about 50 corporate taxpayers, about 10% of the corporate taxpayers claiming the credit. The number of corporate taxpayers benefiting from the ASC option is projected to grow to about 200. It is assumed that the additional carryover credits created by the ASC option will be used against tax in future years.

Minnesota Department of Revenue
Tax Research Division
www.revenue.state.mn.us/research/stats/Pages/Revenue-Analyses.aspx