



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

February 24, 2025

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 173 (Robbins) / S.F. 1237 (Nelson)

	Fund Impact			
	<u>F.Y. 2026</u>	<u>F.Y. 2027</u>	<u>F.Y. 2028</u>	<u>F.Y. 2029</u>
	(000's)			
Corporate Franchise Tax	(\$48,100)	(\$43,300)	(\$49,600)	(\$56,400)
Individual Income Tax	<u>(\$10,900)</u>	<u>(\$8,500)</u>	<u>(\$8,700)</u>	<u>(\$8,800)</u>
General Fund Total	(\$59,000)	(\$51,800)	(\$58,300)	(\$65,200)

Effective beginning with tax year 2025.

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 research and development expenditures during 1984 through 1988 divided by total Minnesota gross receipts for the same years. The fixed-base percentage is capped at 16%.

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

The tax credit is “creditable dollars” times the credit rates. A credit rate of 10% applies to the first \$2 million of creditable dollars. A second-tier 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, the base amount equals 50% of average Minnesota R&D expenditures during the past three years.

A taxpayer may not revoke the election to use the ASC option for a given tax year.

REVENUE ANALYSIS DETAIL

Corporate Franchise Tax

- The corporate revenue estimate is based on Department of Revenue data from Schedule RD forms for tax years 2019 through 2022.
- Data from these forms is incomplete for taxpayers who submitted paper returns. The cost of the proposal was calculated first for taxpayers who submitted electronic returns for four consecutive years, then extrapolated to cover taxpayers with at least one paper return across these four years.
- The estimate was calculated by comparing the base amount claimed by the taxpayer in tax year 2022 to the base amount allowed under the ASC. It is assumed that taxpayers who would be eligible for a larger credit under the ASC would take the election.
- Because the research credit is nonrefundable, the majority of additional credits will be carried over to be used in future tax years due to limited tax liability. Therefore, the final estimate is the sum of two components: the current year credit amount and a portion of the ongoing increase to the credit carryover. The proportion of the increased carryover claimed each year is assumed to equal the average net amount the carryover is drawn down, divided by the total amount of the previous credit carryover for tax year 2022.
- Taxpayers with four years of electronic returns comprise about 38% of current research credit expenditures, and about 48% of the total previous year carryover amount for tax year 2022. The revenue impact for taxpayers with at least one year of paper returns is assumed to be proportional to their share of these totals.
- Growth rates for the current year credit amount and the increase to the ongoing credit carryover are assumed to equal the growth rates from 2021 to 2022 of the current research credit and the carryover from previous years, respectively.
- The tax year 2025 impact was allocated to fiscal year 2026. All other tax year impacts are allocated 30% to the current fiscal year, and 70% to the following fiscal year.

Individual Income Tax

- Detailed data for pass-through claimants of the research credit is unavailable. To estimate the revenue impact for the individual income tax, the first-year revenue impact for the corporate credit was divided by the total corporate research credit expenditures for tax year 2022 to calculate the proportional impact. The proportional impact was then applied to projected expenditures of the individual credit under current law.
- Growth rates for the individual credit are based on the average growth rate of expenditures for the individual credit from tax years 2018 to 2022, based on data from the Department of Revenue's individual income tax population file.
- The tax year 2025 impact was allocated to fiscal year 2026. All other tax year impacts are allocated 30% to the current fiscal year, and 70% to the following fiscal year.

Number of Taxpayers: The proposal would reduce current tax liability for about 300 corporate taxpayers based on tax year 2022 data from companies who submitted only electronic returns over the period 2019-2022. The number of individual income taxpayers and corporate taxpayers with at least one paper return who would have reduced tax liability is unknown.

Minnesota Department of Revenue
Tax Research Division
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