

Minnesota Research and Development Tax Credit

December 2024

Minnesota allows businesses conducting research and development to claim research credits against their corporate franchise taxes or individual income taxes (for pass-through tax entities, such as LLCs and S corporations). The credit is based on the federal credit for increasing research activities, but is limited to research done in Minnesota. The credit provides an incentive for businesses to invest in research and development in Minnesota.

Qualifying research expenses

Under the federal definition used by Minnesota, “qualifying research expenses” must be made to discover technological information that is applied to develop a new or improved business component (e.g., a product or process). The expenditures could be intended to improve quality, performance, reliability, or something similar. The expenditures typically are for wages of the business’s employees, supplies purchased, or amounts paid to contractors to do research for the business.

The credit is incremental

The credit applies to research over a base amount. The federal definition of “qualified research expenses” is limited to the increase in research expenditures over a “base amount,” making the credit an “incremental” credit. This base amount is expressed as a percentage of the business’s gross receipts (Minnesota gross receipts for the Minnesota credit). The percentage is determined for each business based on the percentage its research spending was of its 1984-1988 gross receipts (for the businesses starting up after 1988, 3 percent is used) with a maximum of 16 percent. This incremental credit structure is intended to make the credit more cost effective in stimulating research by disallowing the credit for the normal or basic research the business would otherwise do. For example, a business whose research is a constant percentage of its gross receipts would not be allowed the credit, because it had not increased its research “effort.”

50-percent limit applies. The credit cannot exceed 50 percent of the business’s research expenditures, and many businesses’ credits are determined under that rule because their research is well above their base amount. This typically occurs for Minnesota-based multistate businesses, because their base amounts are calculated using Minnesota gross receipts, a relatively low amount, while their Minnesota research often relates to their entire operations. Since these businesses qualify for a credit based on 50 percent of their research spending, their credits are not necessarily dependent on increasing their research.

Computation of the credit

The Minnesota credit has a two-tiered rate structure; a higher rate (10 percent) applies to the first \$2 million of Minnesota qualified research expenses and a lower rate (4 percent) for the amount over that.

Credit is not refundable

The credit is not refundable; it cannot exceed the liability for tax. However, a unitary business (that is, a business with two or more corporations or other entities that are part of one business) may allocate the

credit among its individual corporations to fully use the credit. If the credit still exceeds the liability for tax, it can be carried over and used to reduce taxes in later tax years (for up to 15 tax years).

Cost of the credit

The cost of the credit has increased significantly in recent years, along with the growth in corporate franchise tax liability and increases in investment research and development. Estimates from the Minnesota Department of Revenue's Tax Expenditure Budget for the cost of this credit under both the individual income and corporate franchise taxes are provided in the table below.

Fiscal year	Individual income tax	Corporate franchise tax	Total
2020	\$30,800,000	\$56,200,000	\$87,000,000
2021	\$32,600,000	\$58,500,000	\$91,100,000
2022	\$34,200,000	\$62,300,000	\$96,500,000
2023	\$36,200,000	\$64,100,000	\$100,300,000
2024	\$33,500,000	\$111,300,000	\$144,800,000
2025	\$34,800,000	\$115,200,000	\$150,000,000
2026	\$36,100,000	\$116,000,000	\$152,100,000
2027	\$37,500,000	\$116,100,000	\$153,600,000

Notes:
The fiscal year 2021 figures use the estimates provided in the 2020 Tax Expenditure Budget.
The fiscal year 2022 and 2023 figures use the estimates provided in the 2022 Tax Expenditure Budget.
The fiscal year 2024 through 2027 figures use the estimates provided in the 2024 Tax Expenditure Budget.

Amortization of research and development costs

Prior to tax year 2022, the Internal Revenue Code allowed research expenditures, including certain operating costs but not including equipment and buildings, to be expensed (that is, deducted in the year incurred rather than over a period of years). This deduction is required to be reduced if the credit is claimed, or alternatively, a taxpayer may elect a reduced credit amount. Due to changes in the 2017 Tax Cuts and Jobs Act, these expenses must be deducted over a period of five years (for domestic expenses) or 15 years (for foreign expenses). Equipment and buildings are tangible property and subject to standard depreciation rules.



**MN HOUSE
RESEARCH**

Minnesota House Research Department provides nonpartisan legislative, legal, and information services to the Minnesota House of Representatives. This document can be made available in alternative formats.