



Analysis of the New Michigan R&D Tax Credit by Prime Tax Group

Effective for TY2025, Michigan has reintroduced a state-level Research & Development (R&D) Tax Credit through Public Acts 186 & 187 (2024). This initiative aligns with IRC §41 and is designed to highly incentivize in-state research activities, foster innovation, and enhance competitiveness. This lucrative credit is available to both Corporate Income Tax (CIT) taxpayers and flow-through entities that perform qualified R&D business activities within Michigan.

Eligibility

- **Corporate Income Tax (CIT) taxpayers:** Businesses subject to Michigan's 6% CIT.
- **Flow-through entities:** Partnerships, LLCs, and S corporations not subject to CIT or the retired Michigan Business Tax (MBT).
- **Requirement:** Taxpayers must incur qualified research expenses (QREs) exceeding a defined base amount derived from the average of the previous three years' QREs.

Qualified Research Expenses (QRE)

Eligible expenses conform to IRC §41 definitions and must be incurred within Michigan. They include:

- Wages paid for in-house qualified research activities.
- Supplies used or consumed in the conduct of qualified research.
- Payments for qualified contract research performed within Michigan.

Credit Calculation

- **Base Credit:** 3% of QREs up to the base amount.
- **Incremental Credit:**
 - Small businesses (<250 employees): 15% of QREs above base, up to \$250,000/year.
 - Larger businesses (≥250 employees): 10% of QREs above base, up to \$2 million/year.
- **Collaboration Bonus:** An additional 5% of QREs above the base amount (up to \$200,000) for research done in collaboration with a Michigan research university under a formal written agreement.

Program Cap and Allocation

- **Annual Program Cap:** \$100 million total.
- **Small Business Set-Aside:** \$25 million reserved annually for businesses with fewer than 250 employees.

Claiming the Credit

- **Tentative Claims:** Must be filed by **March 15** following the tax year in which R&D expenditures are incurred.
- **Final Claim:** Filed on the Michigan Corporate Income Tax return.
- **Proration:** If total credits exceed the cap, claims will be prorated proportionally.

Sources: *Public Act 186 & 187 of 2024; Treasury Notice (2024), Michigan House Fiscal Agency Bill Analysis (2024).*

DEFINITIONS

- **Qualified Research Expenses (QREs):** Defined under **IRC §41(b)**, QREs include in-house wages, supplies, and contract research costs related to qualified research. The research must meet the four-part test: (1) permitted purpose, (2) technological in nature, (3) elimination of uncertainty, and (4) process of experimentation.
- **Base Amount:** As per **IRC §41(c)**, the base amount is the average of the prior three years' QREs. Michigan simplifies this rule compared to the federal fixed-base percentage calculation.
- **Wages:** Under **IRC §41(b)(2)(A)**, wages include amounts paid for direct research, supervision, or support of qualified R&D, determined using **IRC §3401(a)** wage withholding rules.
- **Supplies:** According to **IRC §41(b)(2)(C)**, supplies are non-depreciable tangible property used in R&D (*excluding land and capital equipment*).
- **Contract Research Expenses:** Per **IRC §41(b)(3)**, expenses paid to third parties for conducting research on behalf of the taxpayer. Must be performed in Michigan to qualify under state law, and the taxpayer must retain substantial rights and bear economic risk.
- **Michigan Corporate Income Tax (CIT):** Codified at **MCL 206.601 et seq.**, the CIT imposes a 6% tax on corporations with a business presence in Michigan. Flow-through entities are not subject to the CIT.
- **Michigan Business Tax (MBT):** Defined under **MCL 208.1101 et seq.**, the MBT was replaced by the CIT for most taxpayers beginning in 2012. However, certain entities may still file under the MBT to claim legacy credits.

CONCLUSION & STRATEGIC CONSIDERATIONS

The reinstatement of Michigan's R&D tax credit realigns the state with over thirty (30) others offering similar incentives. By leveraging both the base and incremental structures and rewarding university collaboration, the program aims to spur local innovation and industrial partnerships. However, the annual cap and proration mechanism may limit credit utilization, especially for large claimants. Identifying & qualifying business activities requires in-depth understanding of the applicable IRS & Michigan Tax Code and the reporting requirements for each. Companies should act early to file tentative claims and ensure alignment with IRC §41 documentation standards to substantiate eligibility.