STATE OF MINNESOTA | TAX COURT

COUNTY OF RAMSEY | REGULAR DIVISION

International Business Machines Corporation and Subsidiaries,

Appellants,

vs.

Commissioner of Revenue,

Appellee.

ORDER ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

File No. 9053-R

Filed: August 17, 2018

This matter came before The Honorable Bradford S. Delapena, Chief Judge of the Minnesota Tax Court, on the parties' cross-motions for summary judgment.

Walter A. Pickhardt, Faegre Baker Daniels LLP, represents appellants International Business Machines Corporation and Subsidiaries.

Wendy S. Tien, Assistant Minnesota Attorney General, represents appellee Commissioner of Revenue.

The parties dispute the computation of Appellants International Business Machines Corporation and Subsidiaries' Minnesota Research and Development Credit (Minnesota R&D Credit), authorized by Minn. Stat. § 290.068 (2010), for the tax year ended December 31, 2011. We grant in part and deny in part each party's motion for summary judgment.

The court, upon all the files, records, and proceedings herein, now makes the following:

ORDER

1. Appellants International Business Machines Corporation and Subsidiaries' motion for summary judgment is granted in part and denied in part. Specifically, we agree with IBM that, for the tax year in issue, the Minnesota "base amount" had to be computed using federal

(nationwide) gross receipts in the denominator of the fixed-base percentage. *See infra* § IV.B. IBM's motion is denied in all other respects.

2. Appellee Commissioner of Revenue's motion for summary judgment is granted in part and denied in part. Specifically, we agree with the Commissioner that, for the tax year in issue, Minnesota law incorporated the federal minimum base amount provision as part of the state-law definition of "base amount," and did *not* incorporate the federal election of alternative simplified credit. *See infra* §§ IV.A, IV.C. The Commissioner's motion is denied in all other respects.

3. Pursuant to the parties' stipulated computation, IBM's Minnesota R&D Credit for the 2011 tax year is $2,378,713.[1]

4. The Commissioner shall calculate the amount of the Minnesota R&D Credit carryovers to the 2011 tax year,[2] and shall file and serve that calculation no later than September 21, 2018.

5. No later than ten days after service of the Commissioner's calculation, IBM may file and serve objections.

6. No later than five days after service of IBM's objections, the Commissioner may file and serve a response, if any.

7. If IBM files no objection to the Commissioner's calculation, the court will promptly file a final order for judgment. If IBM does file objections, the court will determine the appropriate carryovers, if any, and then file a final order for judgment.

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[1] *See* Stipulation of Facts ¶ 33 (filed Jan. 10, 2018); Ex. J-7.

[2] *See* Stip. ¶¶ 40-41.

IT IS SO ORDERED.

BY THE COURT,

Bradford S. Delapena, Chief Judge
MINNESOTA TAX COURT

DATED: August 17, 2018

MEMORANDUM

In 1981, hoping to stimulate domestic research and development activity, Congress amended the Internal Revenue Code by creating a research and development tax credit (R&D credit). Economic Recovery Act of 1981, Pub. L. No. 97-34, 95 Stat. 172. In 1982, the Minnesota Legislature created a state R&D credit to stimulate research and development activities in Minnesota. Act of Jan. 15, 1982, ch. 2, art 3, § 6, 1982 Minn. Laws 16, 87 (1981 3rd Sp. Sess.) (codified at Minn. Stat. § 290.068 (1982)). This case involves the computation of Appellants International Business Machines Corporation and Subsidiaries' 2011 Minnesota R&D Credit.

The 2011 version of the Minnesota R&D Credit, codified at Minn. Stat. § 290.068 (2010), was based on its federal counterpart and incorporated concepts used in federal law, such as "qualified research" and "base amount." By statute, however, the Legislature redefined those terms for state-law purposes. Thus, the term "qualified research" under Minnesota law meant "qualified research as defined in section 41(d) of the Internal Revenue Code, *except that the term does not include qualified research conducted outside the state of Minnesota*." Minn. Stat. § 290.068, subd. 2(b) (emphasis added). Specifically because the Legislature modified the

components used to compute the Federal R&D Credit, it was necessary to separately compute the Minnesota credit.

This case involves two computational issues regarding the Minnesota R&D Credit. Each turns on the degree to which Minnesota law (a) incorporated and (b) modified federal law. The first issue is whether the definition of "base amount" that Minnesota incorporated from federal law included a "minimum base amount" provision. IBM contends that Minnesota law did *not* incorporate the federal minimum base amount provision;[3] the Commissioner argues that it did.[4] The parties have stipulated to the tax consequences for IBM of both alternatives.[5]

The second computational issue is whether Minnesota law modified for state-law purposes the federal definition of "aggregate gross receipts." IBM contends that Minnesota did *not* modify the definition;[6] the Commissioner argues that it must have.[7] Again, the parties have stipulated to the tax consequences of both alternatives.[8] The final issue is whether Minnesota incorporated a federal provision allowing taxpayers to choose an alternative method for calculating the Federal R&D Credit.[9] Each issue presents a question of statutory interpretation.

Before resolving the parties' dispute, we provide some background on the federal and state R&D credits and set forth the pertinent historical and procedural facts, all of which are stipulated.

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[3] IBM's Mem. Supp. Summ. J. 11-20.

[4] Comm'r's Mem. Supp. Summ. J. 12-16.

[5] Stip. ¶¶ 35-37; Ex. J-8.

[6] IBM's Mem. Supp. Summ. J. 7-11.

[7] Comm'r's Mem. Supp. Summ. J. 16-25.

[8] Stip. ¶¶ 32-34; Ex. J-7.

[9] *See* IBM's Mem. Supp. Summ. J. 20-21; Comm'r's Mem. Supp. Summ. J. 25-28.

I. BACKGROUND OF THE R&D CREDITS

Because the Minnesota R&D Credit was based on its federal counterpart, we begin with the federal credit.

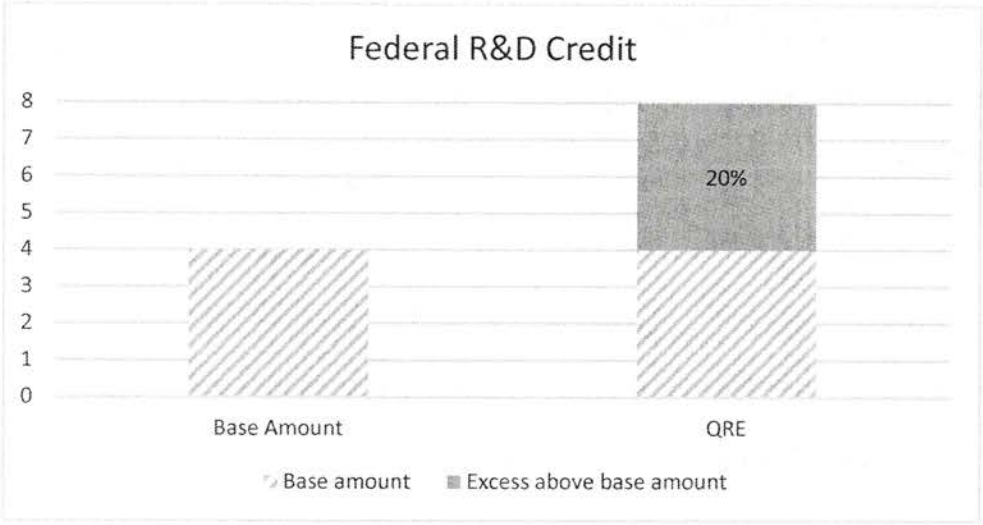
A. The Federal R&D Credit

In 1981, Congress enacted the first income tax credit for increasing research and development activities above existing levels as part of the Economic Recovery Act of 1981. Economic Recovery Act of 1981, Pub. L. No. 97-34, 95 Stat. 172. During 2011, the tax period in issue, I.R.C. § 41, which codified the Federal R&D Credit, provided in part as follows:

> (a) GENERAL RULE. [T]he research credit determined under this section for the taxable year shall be an amount equal to the sum of—
>
> (1) 20 percent of the excess (if any) of—
>
> (A) the qualified research expenses for the taxable year, over
>
> (B) the base amount ....

I.R.C. § 41(a)(1) (2006).[10] Federal law defined the two amounts to be compared in computing the credit. *See* I.R.C. §§ 41(b) (defining "qualified research expenses"); 41(c) (defining "base amount"). Computation of the federal credit can be represented as follows:

[10] Although the subsection 41(a)(1) credit was but one component of a larger federal research credit, *see generally* I.R.C. § 41(a)(1)-(a)(3), Minnesota adopted only a subsection (a)(1) analog. Consequently, subsection (a)(1) is the only one relevant here.



As this depiction suggests, the determination of federal base amount was consequential, because it directly affected the amount of qualifying research expenses (QREs) subject to the twenty percent credit.

The two computational issues in this case revolve around Minnesota's adoption and modification of the federal "base amount." Federal law provided, in part:

> (1) IN GENERAL. The term "base amount" means the product of—
>
> (A) the fixed-base percentage, and
>
> (B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined ....

I.R.C. § 41(c)(1) (2006). The "fixed-base percentage" necessary for this computation was "the percentage which the aggregate qualified research expenses of the taxpayer for taxable years [1984-88] is of the aggregate gross receipts of the taxpayer for such taxable years." I.R.C. § 41(c)(3) (2006). Generally, then, a taxpayer's federal "base amount" was computed using the following formula:

$$\frac{\text{(Aggregate QREs 1984-88)}}{\text{(Aggregate gross receipts 1984-88)}} \times \text{(Average annual gross receipts for the four years preceding the taxable year)}$$

As this equation reveals, Congress selected the period 1984 through 1988 as a reference period. A taxpayer's federal "base amount" as computed using this formula could not be *less than*

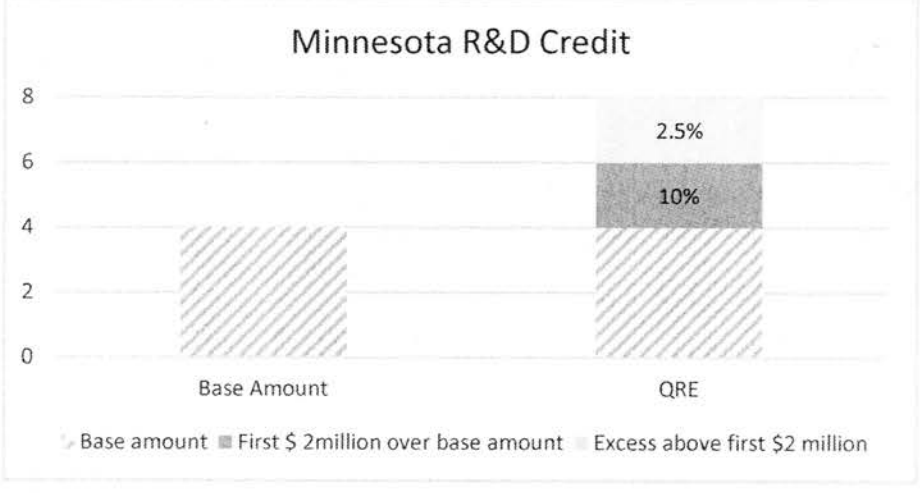
fifty percent of its "qualified research expenses" for the credit year. *See* I.R.C. § 41(c)(2) (2006) (minimum base amount).

B. The Minnesota Credit

To stimulate research and development in Minnesota, the Legislature adopted the Minnesota R&D Credit in 1981. Act of Jan. 15, 1982, ch. 2, art 3, § 6, 1982 Minn. Laws 16, 87 (1981 3rd Sp. Sess.)(codified at Minn. Stat. § 290.068 (1982)). During 2011, Minn. Stat. § 290.068, provided in pertinent part as follows:

> Subdivision 1. **Credit allowed.** A corporation ... [is] allowed a credit against the tax computed under this chapter for the taxable year equal to:
>
> (a) ten percent of the first $2,000,000 of the excess (if any) of
>
> (1) the qualified research expenses for the taxable year, over
>
> (2) *the base amount*; and
>
> (b) 2.5 percent on all of such excess expenses over $2,000,000.

Minn. Stat. § 290.068, subd. 1 (2010) (emphasis added). Computation of the Minnesota credit can be represented as follows:



As this depiction suggests, the determination of state base amount was also consequential. Assuming $8 million in state QREs, for example, a base amount of $3 million would produce a

state R&D credit of $275,000;[11] a base amount of $5 million, a credit of $225,000;[12] and a base amount of $7 million, a credit of $100,000.[13] Thus, for a given quantity of QREs, as base amount increased, the credit decreased, and vice versa.

II. FACTS AND PROCEDURAL HISTORY

This matter is here on stipulated facts. Appellants International Business Machines Corporation and Subsidiaries (IBM), are among the world's leading technology companies.[14] Although incorporated in New York, IBM engages in significant research and development activities at its facility in Rochester, Minnesota.[15] IBM timely filed a 2011 Minnesota corporate franchise tax return[16] claiming a $322,881 Minnesota R&D Credit.[17]

In October 2013, after an audit, the Commissioner issued a Notice of Change in Tax, reducing IBM's 2011 Minnesota R&D Credit to $313,195.[18] On April 15, 2016, IBM filed an amended return, claiming a 2011 state R&D credit of $4,395,399 (exclusive of carryovers), and requesting a refund.[19] The Commissioner denied IBM's refund request in March 2017.[20] IBM timely filed a Notice of Appeal with this court on May 8, 2017.[21] On January 10, 2018, IBM and

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[11] ($2,000,000 x 0.1) + ($3,000,000 x 0.025) = $275,000.

[12] ($2,000,000 x 0.1) + ($1,000,000 x 0.025) = $225,000.

[13] ($1,000,000 x 0.1) = $100,000.

[14] Stip. ¶ 2.

[15] Stip. ¶¶ 1-2.

[16] Stip. ¶ 3; Ex. J-2.

[17] Stip. ¶ 4; Ex. J-2, at 42.

[18] Stip. ¶¶ 5-6; Ex. J-3, at 120.

[19] Stip. ¶ 24; Ex. J-5, at 124-25.

[20] Stip. ¶ 24; Ex. J-1.

[21] Not. Appeal (filed May 8, 2017).

the Commissioner filed cross-motions for summary judgment.[22] For purposes of oral argument *only*, this case was consolidated with another that raises similar issues, *General Mills, Inc. v. Commissioner of Revenue*, No. 9016-R (filed Feb. 2, 2017).[23]

III. GOVERNING PRINCIPLES

A. Summary Judgment Standard

Summary judgment shall be rendered if the pleadings, the record in the case, and any supporting affidavits show that there is no genuine issue as to any material fact and that a party is entitled to judgment as a matter of law. Minn. R. Civ. P. 56.03; *DLH, Inc. v. Russ*, 566 N.W.2d 60, 69 (Minn. 1997). When parties file cross-motions for summary judgment, they tacitly agree that there are no genuine issues of material fact. *Am. Family Mut. Ins. Co. v. Thiem*, 503 N.W.2d 789, 790 (Minn. 1993). Thus, summary judgment is a suitable vehicle for addressing the application of law to undisputed facts. *See A. J. Chromy Constr. Co. v. Commercial Mech. Serv., Inc.*, 260 N.W.2d 579, 581 (Minn. 1977).

B. Statutory Interpretation

"The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature." Minn. Stat. § 645.16 (2016). Legislative intent is determined "primarily from the language of the statute itself." *Brayton v. Pawlenty*, 781 N.W.2d 357, 363 (Minn. 2010) (quoting *Gleason v. Geary*, 214 Minn. 499, 516, 8 N.W.2d 808, 816 (1943)). Courts use statutory canons of interpretation to determine a statute's meaning. *Laase v. 2007 Chevrolet Tahoe*, 776 N.W.2d 431, 435 (Minn. 2009). Under pertinent canons, "words and phrases are construed according to rules of grammar and according to their common and approved usage; but

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[22] IBM's Not. Mot. & Mot. Summ. J. (filed Jan. 10, 2018); Comm'r Not. Mot. & Mot. Summ. J. (filed Jan 10, 2018).

[23] Tr. 3-6.

technical words and phrases and such others as have acquired a special meaning ... are construed according to such special meaning or their definition." Minn. Stat. § 645.08(1) (2016).

IV. ANALYSIS

The first two issues in this case involve the proper computation of the Minnesota base amount. The third issue is whether Minnesota incorporated a federal provision allowing taxpayers to choose an alternative method for calculating the Minnesota R&D Credit.

A. Minimum Base Amount

The first issue is whether the definition of "base amount" Minnesota incorporated from federal law included the "minimum base amount" limitation. IBM contends that Minnesota law did *not* incorporate the federal minimum base amount provision,[24] whereas the Commissioner argues that it did.[25] The parties have stipulated to the tax consequences for IBM of both alternatives.

Because this issue raises a question of statutory interpretation, we set forth the text of the controlling state and federal statutes for tax year 2011. Minnesota Statutes section 290.068 provided in pertinent part:

> Subd. 2. **Definitions.** For purposes of this section, the following terms have the meanings given.
>
> ...
>
> (c) "Base amount" means base amount as defined in section 41(c) of the Internal Revenue Code, except that ....

Minn. Stat. § 290.068, subd. 2(c) (2010). Section 41(c) of the Internal Revenue Code provided in pertinent part:

> (c) Base Amount

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[24] IBM's Mem. Supp. Summ. J. 11-20; Tr. 7-9.

[25] Comm'r's Mem. Supp. Summ. J. 12-16; Tr. 38-40.

(1) IN GENERAL. The term "base amount" means the product of—

(A) the fixed-base percentage, and

(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the "credit year").

(2) MINIMUM BASE AMOUNT. In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

(3) FIXED-BASE PERCENTAGE.

(A) IN GENERAL. Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, is of the aggregate gross receipts of the taxpayer for such taxable years.

I.R.C. § 41(c)(1)-(c)(3)(A) (2006).

The critical language here is the portion of Minn. Stat. § 290.068, subd. 2(c), providing that "base amount" for purposes of the Minnesota R&D Credit "means base amount as defined in section 41(c) of the Internal Revenue Code." The determinative question is: Which provisions of I.R.C. § 41(c) *defined* "base amount," and were therefore incorporated into Minnesota law?

The term "define" means: "(1) To state or explain explicitly. (2) To fix or establish (boundaries or limits). (3) To set forth the meaning of (a word or phrase)." *Define*, *Black's Law Dictionary* (10th ed. 2014). Subsection (c)(1) was surely part of section 41(c)'s definition of base amount: it set forth the general meaning of that term as the product of "the fixed-base percentage" and a specified gross receipts figure. The provisions of subsection (c)(1) were therefore incorporated into Minnesota law.

It is readily apparent that Minnesota law *also* incorporated the provisions of subsection (c)(3). For that subsection explained "fixed-base percentage." Had this explanation *not* been incorporated into state law, then "fixed-base percentage" would have had no *state-law* meaning, and there would have been no *state-law* basis for computing the Minnesota "base

amount" under the incorporated provisions of subsection (c)(1). "[T]he legislature does not intend a result that is ... impossible of execution ...." Minn. Stat. § 645.17(1) (2016). Because subsection (c)(1) was inherently incomplete, and could not stand alone as a definition of base amount (as the Legislature surely recognized), we conclude that subsection (c)(3) was part of section 41(c)'s definition of base amount, and that its provisions were incorporated into Minnesota law.

We now turn to the intervening provision, subsection (c)(2): "In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year." I.R.C. § 41(c)(2). As previously indicated, the word "define" means, in part: "To fix or establish (boundaries or limits)." *Define*, *Black's Law Dictionary*. Subsection (c)(2) performed precisely this definitional function: it limited the *general* meaning of base amount to fifty percent or more of qualified research expenses for the credit year. We therefore conclude that this subsection, too, was part of section 41(c)'s definition of base amount, and that its provisions were incorporated into Minnesota law.

None of the remaining subsections of section 41(c) defined base amount. Subsections (4), (5), and (6), were titled, respectively, "Election of Alternative Incremental Credit," "Election of Alternative Simplified Credit," and "Consistent Treatment of Expenses Required." *See* I.R.C. § 41(c)(4)-(c)(6).

We find unpersuasive IBM's several arguments that the federal minimum base amount provision was *not* incorporated into Minnesota law. IBM first argues that "[t]he term 'define' should be understood in accordance with its common usage, and it is commonly used 'to discover or set forth the meaning of (something, such as a word).' " [26] On this basis, IBM argues that

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[26] IBM's Mem. Supp. Summ. J. 12 (quoting *Define*, *Merriam Webster's Collegiate Dictionary* (11th ed. 2014)).

section 41(c)'s definition of base amount "begins and ends in subsection (c)(1)."[27] This is just cherry-picking, however, because the quoted definition *further* provides that "define" means, "to fix or mark the limits of: DEMARCATE." *Define*, *Merriam Webster's Collegiate Dictionary* (11th ed. 2014). As we indicate above, that is precisely the function subsection (c)(2) plays in section 41(c)'s overall definition of base amount.

Second, IBM argues that subsection (c)(2) cannot define base amount because it *uses* that term.[28] We disagree. Although subsection (c)(2) *includes* the term base amount, its *mention* of that term is essential to the text's definitional function: ensuring that "[i]n no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year." I.R.C. § 41(c)(2).[29]

IBM next argues that in *Stanley Works v. Commissioner*, the U.S. Tax Court "observed the principle that a limitation placed on a previously defined term is not part of the definition of that term."[30] As an initial matter, we doubt that the *Stanley Works* Court intended to announce a general principle. In any event, *Stanley Works* rested on the court's conclusion that "by its terms," the limiting provision in question "contained no language pertaining to the definition of" the contested statutory term. *Stanley Works*, 87 T.C. at 419. Instead of pertaining to *meaning*, the

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[27] IBM's Mem. Supp. Summ. J. 13.

[28] IBM's Mem. Supp. Summ. J. 14.

[29] Discussing the legislative history of section 41(c), IBM asserts that subsection (c)(2) is a computation limit separate from the determination of base amount. IBM's Mem. Supp. Summ. J. 16-18. Because we conclude that subsection (c)(2)—by its plain meaning—is part of the definition of base amount, however, we do not consider legislative history, an extrinsic aid to construction.

[30] IBM's Mem. Supp. Summ. J. 14 (discussing *Stanley Works v. Comm'r*, 87 T.C. 389, 419 (1986)).

limiting provision affected the *operation* of the entire statute. *Id.* Here, we conclude that subsection (c)(2) pertains directly to the meaning of base amount, by limiting that meaning.

Finally, IBM argues that if subsection (c)(2) is incorporated into Minnesota law, then the Minnesota R&D Credit "would be subject to two sets of limitations, reducing the credit's marginal rate to just 1.25 percent."[31] IBM continues: "It is hard to believe that the Legislature intended such a miserable, paltry credit for increasing Minnesota-based research activities."[32] Again we disagree. As the examples set forth earlier demonstrate, changing the allowable base amount certainly affects the amount of the credit for any given level of qualifying research expenses. *See supra* § I.B. But adopting a base-amount limitation does not alter the statutory rates. Instead, it potentially reduces the qualified research expenses *subject to the stated rates*.[33]

We agree with the Commissioner that Minnesota law incorporated the federal minimum base amount provision as part of the state-law definition of "base amount." Consequently, we grant the Commissioner's motion for summary judgment on that issue.

B. Fixed-Base Percentage

The second issue also involves the computation of Minnesota base amount. Resolution of this issue turns on the degree to which the Minnesota Legislature altered for state-law purposes the two terms multiplied to compute federal base amount: (1) the fixed-base percentage, and (2) "the average annual gross receipts of the taxpayer" for the four preceding years.

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[31] IBM's Mem. Supp. Summ. J. 18.

[32] IBM's Mem. Supp. Summ. J. 19.

[33] This point is perfectly illustrated by the parties' stipulated re-computation of IBM's Minnesota R&D Credit, which applies the minimum base amount limitation *and* nevertheless uses the stated statutory rates. Stip. ¶ 33.

We again set forth relevant federal provisions, emphasizing several terms on which analysis must focus. During the time period in issue, I.R.C. § 41 provided, in part:

> (c) Base Amount
>
> (1) IN GENERAL. The term "base amount" means the product of—
>
> (A) the fixed-base percentage, and
>
> (B) the *average annual gross receipts* of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined ....
>
> ...
>
> (3) FIXED-BASE PERCENTAGE.
>
> (A) IN GENERAL. Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the *aggregate qualified research expenses* of the taxpayer for taxable years [1984 through 1988] is of the *aggregate gross receipts* of the taxpayer for such taxable years.

I.R.C. § 41(c)(1), (c)(3) (emphasis added). Under these provisions, a taxpayer's federal "base amount" was computed as follows:

$$\frac{\text{(Aggregate QREs 1984-88)}}{\text{(Aggregate gross receipts 1984-88)}} \times \text{(Average annual gross receipts for the four years preceding the taxable year)}$$

The Minnesota Legislature adopted the federal base amount concept but, by furnishing state-law definitions of critical terms, modified its computation for state-law purposes. During the relevant time period, Minnesota law provided, in part:

> Subd. 2. **Definitions.** For purposes of this section, the following terms have the meanings given.
>
> (a) "Qualified research expenses" means (i) qualified research expenses and basic research payments as defined in section 41(b) and (e) of the Internal Revenue Code, except it does not include expenses incurred for qualified research or basic research conducted outside the state of Minnesota pursuant to section 41(d) and (e) ....
>
> (b) "Qualified research" means qualified research as defined in section 41(d) of the Internal Revenue Code, except that the term does not include qualified research conducted outside the state of Minnesota.
>
> (c) "Base amount" means base amount as defined in section 41(c) of the Internal Revenue Code, except that the average annual gross receipts must be

> calculated using Minnesota sales or receipts under section 290.191 and the definitions contained in clauses (a) and (b) shall apply.

Minn. Stat. § 290.068, subd. 2(a)-(c). By its plain meaning, these provisions modified the formula for computing base amount in two respects.

First, by providing state-law definitions of "qualified research" and "qualified research expenses," subdivisions 2(a) and 2(b) altered the *numerator* of the "fixed-base percentage," limiting the "qualified research expenses" to be aggregated to those incurred in Minnesota.[34] Second, by providing that "the average annual gross receipts must be calculated *using Minnesota sales or receipts*," subdivision 2(c) limited the "average annual gross receipts" to be multiplied by the fixed-base percentage. As a result of these modifications, a taxpayer's Minnesota "base amount" was computed using the following formula:

$$\frac{\text{(Aggregate } \textbf{Minn.} \text{ QREs 1984-88)}}{\text{(Aggregate gross receipts 1984-88)}} \times \text{(Average annual } \textbf{Minn.} \text{ gross receipts for the four years preceding the taxable year)}$$

In sum, by furnishing state-law definitions of particular federal terms, the Minnesota Legislature statutorily modified two of the three terms in the equation for computing base amount.

The issue presented is whether the Minnesota Legislature *also* modified for state-law purposes the *denominator* of the fixed-base percentage—whether it altered the definition of "aggregate gross receipts" to refer exclusively to *Minnesota* gross receipts. IBM argues that it did *not* and, consequently, that under the plain meaning of subdivision 2(c), the Minnesota base amount must be "computed using federal [nationwide] gross receipts in the denominator."[35] The Commissioner contends that "[f]or purposes of calculating the Minnesota R&D Credit, the reference to 'aggregate gross receipts' in IRC Section 41(c)(3) means *Minnesota aggregate gross*

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[34] Under I.R.C. § 41(c)(3)(C), the maximum fixed-base percentage is sixteen percent. The parties agree that this provision applies to the Minnesota R&D Credit. Stip. ¶¶ 17, 21.

[35] IBM's Mem. Supp. Summ. J. 7-11; *see* Tr. 26-28.

receipts." [36] We conclude that the Commissioner's proposed interpretation is incompatible with the text of Minn. Stat. § 290.068, subdivision 2(c), which directly supports IBM's contrary position.

Federal law defined the three-word phrase "qualified research expenses." I.R.C. § 41(b). The Minnesota Legislature redefined for state-law purposes the same three-word phrase, so as to exclude from its ambit expenses for research "conducted outside the state of Minnesota." Minn. Stat. § 290.068, subd. 2(a). This modification altered the *numerator* of the "fixed-base percentage" for state-law purposes by limiting the research expenses to be aggregated in the numerator.

Federal law used the four-word phrase "average annual gross receipts." I.R.C. § 41(c)(1)(B). In defining "base amount" for state-law purposes, the Minnesota Legislature limited the meaning of that same four-word phrase by providing: "[t]he *average annual gross receipts* must be calculated using Minnesota sales or receipts ...." Minn. Stat. § 290.068, subd. 2(c) (emphasis added). This directly modified the figure to be multiplied by the fixed-base percentage.

In these respects, the text of Minn. Stat. § 290.068, subdivision 2, is unambiguous, and indicates the Legislature's intent to modify for state-law purposes two particular terms used in federal law. *Brayton*, 781 N.W.2d at 363 ("We determine legislative intent primarily from the language of the statute itself." (internal quotation marks and citation omitted)).

Federal law used the three-word phrase "aggregate gross receipts" to specify the denominator of the fixed-base percentage. I.R.C. § 41(c)(3)(A). We have already concluded that subsection (c)(3)(A) was incorporated into Minnesota law as part of the federal definition of "base

[36] Comm'r's Mem. Supp. Summ. J. 16 (emphasis added); *see* Tr. 57-59.

amount." *See supra* § IV.A. The question is whether the Minnesota Legislature *modified* the term "aggregate gross receipts."

That term did not appear in Minn. Stat. § 290.068: the Legislature neither used the term "aggregate gross receipts" nor redefined it. Particularly in light of statutory text modifying *other* federal terms, the absence of any use or redefinition of "aggregate gross receipts" in state law indicates that the Legislature did *not* intend to modify that term for state-law purposes. Because the term "aggregate gross receipts" was incorporated into state law, but was not modified by state law, it had the same meaning for state-law purposes as it had for federal purposes. Here, again, state law is clear and unambiguous.[37]

The Commissioner's textual arguments that "aggregate gross receipts" means only *Minnesota* gross receipts are unpersuasive. The Commissioner argues that "[t]he Minnesota limitation on 'gross receipts' in [Minn. Stat. § 290.068, subd. 2(c)] plainly was intended to apply to average aggregate gross receipts described in IRC section 41(c)(1)(A) ...." [38] On this basis, the Commissioner argues: "If the term 'average ... gross receipts' were to refer to Minnesota sales or receipts in the context of average annual gross receipts, but to nationwide sales or receipts in the context of average aggregate gross receipts, such a conflicting use of the term would be disfavored." [39] There are at least three problems with this reasoning.

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[37] Because we conclude that Minn. Stat. § 290.068 is unambiguous in this respect as well, we do not consider administrative or legislative interpretations. *See Hutchinson Tech., Inc. v. Comm'r of Revenue*, 698 N.W.2d 1, 14 (Minn. 2005) (noting that courts "look to legislative and administrative interpretations of a statute [only] when the words of the law are not explicit") (citing Minn. Stat. § 645.16 (2004)).

[38] Comm'r's Mem. Supp. Summ. J. 18.

[39] Comm'r's Mem. Supp. Summ. J. 19.

First, Minnesota law does not limit the term "gross receipts." Instead, it limits the broader term, "average annual gross receipts." *See* Minn. Stat. § 290.068, subd. 2(c) ("except that the average annual gross receipts must be calculated using Minnesota sales or receipts"). There is no inconsistent use of the term "gross receipts" because that term is not used in isolation. Second, the Commissioner attempts to manufacture inconsistency by blending terms. Federal law used the four-word term "average annual gross receipts" and the three-word term "aggregate gross receipts." Neither federal nor state law, however, used the Commissioner's four-word coinage "average aggregate gross receipts." Finally, the Commissioner argues that "[t]he Minnesota limitation on aggregate gross receipts is clear from the Minnesota-based limitations section 290.068 subdivisions 2(b) and 2(c) place on other definitions for purposes of the Minnesota R&D Credit."[40] As indicated above, however, we conclude that precisely the *opposite* inference is warranted. The Legislature's express modification of federal law in *other* respects indicates that it did *not* intend to modify federal law in *this* respect.[41]

We also reject the Commissioner's contention that IBM's interpretation "would frustrate the purpose of an incremental credit, which is intended to limit the credit to the increase in research expenditures *over a base amount determined solely by reference to Minnesota receipts*."[42] First, the argument simply *assumes* its own conclusion: that "aggregate gross receipts" include Minnesota gross receipts only. Second, contrary to the Commissioner's contention, there is

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[40] Comm'r's Mem. Supp. Summ. J. 19.

[41] The Commissioner correctly observes that federal law "use[d] the word 'aggregate' to refer to both the taxpayer's research expenses, and its gross receipts ...." Comm'r's Mem. Supp. Summ. J. 18. She then argues that "aggregate" should be consistently interpreted. Comm'r's Mem. Supp. Summ. J. 18-19. We do not disagree. The parties dispute, however, turns not on the meaning or application of the word "aggregate" but, instead, on the scope of what is to be aggregated (e.g., nationwide or only Minnesota gross receipts).

[42] Comm'r's Mem. Supp. Summ. J. 20 (emphasis added).

nothing "absurd" about using nationwide aggregate gross receipts in the denominator of the fixed-base percentage.[43] Doing so simply produces a *different* base amount than that sought by the Commissioner, thereby altering the amount of qualifying research expenditures subject to the credit.

This is really a policy argument disguised as statutory interpretation: "When calculating the fixed-base percentage for the Minnesota R&D Credit, however, *it only makes sense* to take the ratio of aggregate Minnesota research spending to aggregate *Minnesota* gross receipts, not aggregate nationwide gross receipts."[44] We have no difficulty with the Commissioner's suggestion that it would have "ma[de] sense" for the Legislature to "reduce determination of the Minnesota R&D Credit to a Minnesota-only frame of reference."[45] This is not what the text of Minn. Stat. § 290.068 accomplished, however. Nor are we allowed to alter that text.

If the Legislature purposefully chose to use *nationwide* aggregate gross receipts in the denominator of the fixed-base percentage, that is not a policy decision we are at liberty to modify. *See, e.g.*, *Under the Rainbow Child Care Ctr., Inc. v. Cty. of Goodhue*, 741 N.W.2d 880, 889 (Minn. 2007) ("The legislature and governor, not this court, should make the policy judgments that determine the scope of tax exemptions."); *Metro. Sports Facilities Comm'n v. Cty. of Hennepin*, 478 N.W.2d 487, 489 (Minn. 1991) ("Because taxation policy is peculiarly a legislative function, involving political give-and-take and an awareness of local conditions, the courts are very deferential in their review of tax legislation."). If the Legislature intended to use *Minnesota* aggregate gross receipts, but neglected to include language in section 290.068 implementing this

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[43] Comm'r's Mem. Supp. Summ. J. 20-21, 23.

[44] Comm'r's Mem. Supp. Summ. J. 23 (first emphasis added).

[45] Comm'r's Mem. Supp. Summ. J. 23.

intention, we are not free to supply the mistakenly omitted language. *See, e.g.*, *Green Giant Co. v. Comm'r of Revenue*, 534 N.W.2d 710, 712 (Minn. 1995) ("We will not supply that which the legislature purposefully omits or inadvertently overlooks.").

We note that in 2017 the Legislature amended Minn. Stat. § 290.068 to include a Minnesota-specific limitation of "aggregate gross receipts." Subdivision 2(c) now reads: " 'Base amount' means base amount as defined in section 41(c) of the Internal Revenue Code, except that the average annual gross receipts *and aggregate gross receipts* must be calculated using Minnesota sales or receipts ...." Act of May 30, 2017, ch. 1, art. 13, § 10, 2017 Minn. Laws 1017, 1221 (1st Sp. Sess.) (codified at Minn. Stat. § 290.068, subd. 2(c) (Supp. 2017)). This amendment supports our analysis in two important respects. First, by separately using the terms "average annual gross receipts" and "aggregate gross receipts," the amendment verifies that the previous version of subdivision 2(c) did *not* limit the two-word term "gross receipts" (as the Commissioner argues) but, instead, limited only the four-word term "average annual gross receipts." Second, by now *expressly* limiting "aggregate gross receipts" to "Minnesota sales or receipts," the amendment underlines the previous absence of *any* textual basis for such a limitation.

We agree with IBM that, for the tax year in issue, Minnesota base amount had to be "computed using federal gross receipts in the denominator" of the fixed-base percentage.[46] Consequently, we grant IBM's motion for summary judgment on that issue.

C. Alternative Simplified Credit

The final issue is whether Minnesota law incorporated a federal provision allowing taxpayers to choose an alternative method for calculating the Federal R&D Credit. Section 41(c), which contained the federal definition of "base amount," included as subsection (5) a provision

[46] IBM's Mem. Supp. Summ. J. 7, 9-11.

titled "Election of Alternative Simplified Credit." I.R.C. § 41(c)(5). As previously discussed, Minn. Stat. § 290.068 provided in part that "base amount" for state-law purposes "means base amount *as defined in* section 41(c) of the Internal Revenue Code." Minn. Stat. § 290.068, subd. 2(c) (emphasis added). According to IBM, if we conclude that the section 41(c) definition of "base amount" incorporated into Minnesota law the minimum base amount limitation contained in subsection (c)(2), then, "[t]o be consistent, all of I.R.C. § 41(c) would have to be so incorporated, and that would include paragraph (c)(5)." [47] We disagree.

IBM's argument is essentially this. If we reject its claim that I.R.C. § 41(c)(1) *alone* defined "base amount," then we must abandon any effort to discern which *other* subsections of section 41(c) were also part of the definition. We must either accept IBM's selective interpretation of "to define," or conclude that the term furnishes no standard for decision. This claim is meritless.

Relying on the common and approved usage of the word "define," we concluded above that I.R.C. § 41(c)(1) through (c)(3) define the term "base amount" for purposes of federal law, and that those provisions were therefore incorporated into Minnesota law. *See supra* § IV.A. We further concluded that none of the remaining subsections of section 41(c) defined base amount. *Id.* Subsection (c)(5), titled "Election of Alternative Simplified Credit," perfectly illustrates why. That provision provided in part:

> (5) ELECTION OF ALTERNATIVE SIMPLIFIED CREDIT
>
> > (A) IN GENERAL. At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 14 percent (12 percent in the case of taxable years ending before January 1, 2009) of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

[47] IBM's Mem. Supp. Summ. J. 20.

I.R.C. § 41(c)(5). By its plain meaning, this provision pertained to "the credit determined under subsection (a)(1)" rather than to the *meaning* of the term "base amount." Consequently, we hold that the provisions of I.R.C. § 41(c)(5) were not incorporated into Minnesota law, and grant the Commissioner's motion for summary judgment on that issue.

D. Stipulated Tax Consequences

In October 2013, the Commissioner determined that IBM was entitled to a 2011 Minnesota R&D Credit of $313,195.[48] The Commissioner determined that IBM's Minnesota QREs for the 1984 through 1988 reference period were $838,379,120, and used that figure as the numerator of the fixed-base percentage.[49] For the denominator, the Commissioner used IBM's *Minnesota* (rather than nationwide) aggregate gross receipts for the 1984 through 1988 reference period, a figure of $2,475,206,827.[50] The Commissioner thus calculated a fixed-base percentage of 33.87%. Applying the 16% statutory cap on fixed-base percentage contained in I.R.C. § 41(c)(3)(C), however, the Commissioner used 16% as IBM's Minnesota fixed-based percentage.[51]

The Commissioner multiplied this fixed-base percentage by IBM's average annual Minnesota gross receipts for the four preceding years of $1,073,557,698,[52] to compute a 2011 Minnesota base amount of $171,769,232.[53] Having previously determined that IBM's 2011 Minnesota QREs were $178,297,050,[54] the Commissioner derived a *minimum* base amount of

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[48] Stip. ¶¶ 5-6; Ex. J-3, at 120.

[49] Stip. ¶ 13. The parties stipulate that this figure is correct. Stip. ¶ 14.

[50] Stip. ¶ 15. The parties stipulate that this figure is correct. Stip. ¶ 16.

[51] Stip. ¶ 17; Ex. J-3, at 122.

[52] Stip. ¶ 19. The parties stipulate that this figure is correct. Stip. ¶ 20.

[53] Stip. ¶ 21.

[54] Stip. ¶ 7. The parties stipulate that this figure is correct. Stip. ¶ 8.

$89,148,525 (50% of $178,297,050).[55] Because the *computed* base amount of $171,769,232 exceeded the *minimum* base amount of $89,148,525, the Commissioner used the former figure as IBM's 2011 Minnesota base amount.[56]

To determine IBM's 2011 Minnesota R&D Credit, the Commissioner subtracted IBM's 2011 Minnesota base amount ($171,769,232) from its 2011 Minnesota QREs ($178,297,050), deriving a figure of $6,527,818.[57] She allowed IBM a Minnesota R&D Credit equal to 10% of the first $2,000,000 of that amount, and 2.5% of the balance, for a total Minnesota R&D Credit of $313,195.[58]

The parties have stipulated that if IBM prevails on only the fixed-base percentage issue, and not on the minimum base amount issue, as has occurred, IBM is entitled to an increased 2011 Minnesota R&D Credit.[59] The increase occurs because the denominator of the fixed-base percentage changes from *Minnesota* "aggregate gross receipts" for the 1984 through 1988 reference period ($2,475,206,827) to *nationwide* "aggregate gross receipts" for that period ($106,282,970,279).[60] This produces a fixed-base percentage of 0.79%.[61] That lower fixed-base percentage multiplied by IBM's stipulated average annual Minnesota gross receipts for the previous four years ($1,073,557,698) produces a base amount of $8,481,106.[62] Because this figure

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[55] Stip. ¶ 21.

[56] Stip. ¶ 21.

[57] Stip. ¶ 22.

[58] Stip. ¶ 22; Ex. J-4.

[59] Stip. ¶ 33.

[60] Stip. ¶¶ 15-16, 26-27.

[61] Stip. ¶ 28.

[62] Stip. ¶ 28.

is *lower* than IBM's minimum base amount of $89,148,525, the latter figure prevails (and replaces the originally computed base amount of $171,769,232). Thus, the parties have further stipulated:

> A subtraction of [this] Minnesota base amount ($89,148,525) from the Minnesota [2011] QREs ... ($178,297,050) equals $89,148,525. If IBM prevails only on the fixed base percentage issue, the Minnesota R&D Credit is equal to 10 percent of the first $2,000,000 of that amount, plus 2.5 percent of the balance of that amount, for a total Minnesota R&D Credit ... of $2,378,713. That amount does not include carryovers of the Minnesota R&D Credit.[63]

We agree with this stipulated computation, and order the Commissioner to compute any carryovers.

As fully explained above, we grant in part and deny in part each party's motion for summary judgment.

B.S.D.

[63] Stip. ¶ 33.