114TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { 114–113

AMERICAN RESEARCH AND COMPETITIVENESS ACT OF 2015

MAY 14, 2015.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. RYAN of Wisconsin, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 880]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 880) to amend the Internal Revenue Code of 1986 to simplify and make permanent the research credit, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "American Research and Competitiveness Act of 2015".

SEC. 2. RESEARCH CREDIT SIMPLIFIED AND MADE PERMANENT.

(a) IN GENERAL.—Section 41(a) of the Internal Revenue Code of 1986 is amended to read as follows:

"(a) IN GENERAL.—For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of—

"(1) 20 percent 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,

"(2) 20 percent of so much of the basic research payments for the taxable year as exceeds 50 percent of the average basic research payments for the 3 taxable years preceding the taxable year for which the credit is being determined, plus

"(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.".

(b) REPEAL OF TERMINATION.—Section 41 of such Code is amended by striking subsection (h).

(c) CREDIT ALLOWED AGAINST ALTERNATIVE MINIMUM TAX IN CASE OF ELIGIBLE SMALL BUSINESS.—Section 38(c)(4)(B) of such Code is amended by redesignating clauses (ii) through (ix) as clauses (iii) through (x), respectively, and by inserting after clause (i) the following new clause:

"(ii) the credit determined under section 41 for the taxable year with respect to an eligible small business (as defined in paragraph (5)(C), after application of rules similar to the rules of paragraph (5)(D)),".

(d) CONFORMING AMENDMENTS.—

(1) Section 41(c) of such Code is amended to read as follows:

"(c) DETERMINATION OF AVERAGE RESEARCH EXPENSES FOR PRIOR YEARS.—

"(1) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENDITURES IN ANY OF 3 PRECEDING TAXABLE YEARS.—In any case in which the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined, the amount determined under subsection (a)(1) for such taxable year shall be equal to 10 percent of the qualified research expenses for the taxable year.

"(2) CONSISTENT TREATMENT OF EXPENSES.—

"(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the average qualified research expenses, or average basic research payments, taken into account under subsection (a), the qualified research expenses and basic research payments taken into account in determining such averages shall be determined on a basis consistent with the determination of qualified research expenses and basic research payments, respectively, for the credit year.

"(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or basic research payments caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in determining the average qualified research expenses or average basic research payments taken into account under subsection (a).".

(2) Section 41(e) of such Code is amended—

(A) by striking all that precedes paragraph (6) and inserting the following:

"(e) BASIC RESEARCH PAYMENTS.—For purposes of this section—

"(1) IN GENERAL.—The term 'basic research payment' means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

"(A) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

"(B) such basic research is to be performed by such qualified organization.

"(2) EXCEPTION TO REQUIREMENT THAT RESEARCH BE PERFORMED BY THE ORGANIZATION.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (3), subparagraph (B) of paragraph (1) shall not apply.",

(B) by redesignating paragraphs (6) and (7) as paragraphs (3) and (4), respectively, and

(C) in paragraph (4), as so redesignated, by striking subparagraphs (B) and (C) and by redesignating subparagraphs (D) and (E) as subparagraphs (B) and (C), respectively.

(3) Section 41(f)(3) of such Code is amended—

(A)(i) by striking ", and the gross receipts" in subparagraph (A)(i) and all that follows through "determined under clause (iii)",

(ii) by striking clause (iii) of subparagraph (A) and redesignating clauses (iv), (v), and (vi), thereof, as clauses (iii), (iv), and (v), respectively,

(iii) by striking "and (iv)" each place it appears in subparagraph (A)(iv) (as so redesignated) and inserting "and (iii)",

(iv) by striking subclause (IV) of subparagraph (A)(iv) (as so redesignated), by striking ", and" at the end of subparagraph (A)(iv)(III) (as so redesignated) and inserting a period, and by adding "and" at the end of subparagraph (A)(iv)(II) (as so redesignated),

(v) by striking "(A)(vi)" in subparagraph (B) and inserting "(A)(v)",

(vi) by striking "(A)(iv)(II)" in subparagraph (B)(i)(II) and inserting "(A)(iii)(II)",

(B) by striking ", and the gross receipts of the predecessor," in subparagraph (A)(iv)(II) (as so redesignated),

(C) by striking ", and the gross receipts of," in subparagraph (B),

(D) by striking ", or gross receipts of," in subparagraph (B)(i)(I), and

(E) by striking subparagraph (C) and inserting the following new subparagraph:

"(C) ADJUSTMENTS FOR BASIC RESEARCH PAYMENTS.—In the case of basic research payments, rules similar to the rules of subparagraph (A) and (B) shall apply.".

(4) Section 41(f)(4) of such Code is amended by striking "and gross receipts" and inserting "and basic research payments".

(5) Section 45C(b)(1) of such Code is amended by striking subparagraph (D).

(6) Section 45C(c)(2) of such Code is amended—

(A) by striking "base period research expenses" and inserting "average qualified research expenses", and

(B) by striking "BASE PERIOD RESEARCH EXPENSES" in the heading and inserting "AVERAGE QUALIFIED RESEARCH EXPENSES".

(7) Section 280C(c) of such Code is amended—

(A) by striking "basic research expenses (as defined in section 41(e)(2))" in paragraph (1) and inserting "basic research payments (as defined in section 41(e)(1))", and

(B) by striking "basic research expenses" in paragraph (2)(B) and inserting "basic research payments".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2014.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to amounts paid or incurred after December 31, 2014.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

H.R. 880, reported by the Committee on Ways and Means, provides a permanent simplified method for calculating the research credit with a rate of 20 percent, replacing the traditional 20-per-

cent research credit calculation method. H.R. 880 also provides a permanent basic research credit and energy research credit (both with credit rates of 20 percent), and changes the base period for the basic research credit from a fixed period to a three-year rolling average. Additionally, under the bill, eligible small businesses ($50 million or less in gross receipts) would be able to claim the credit against alternative minimum tax ("AMT") liability. A temporary research credit expired for qualified expenditures made after December 31, 2014.

B. Background and Need for Legislation

While the Committee continues actively to pursue comprehensive tax reform as a critical means of promoting economic growth and job creation, the Committee also believes that it is important to provide American employers permanent, immediate tax relief to help encourage economic growth and job creation. By providing a permanent simplified research credit, instead of the temporary measures enacted over the past three decades, H.R. 880 provides much-needed certainty for innovators, enhancing the effectiveness of the credit as an incentive for investments in research and development. Making the alternative simplified method the primary method for calculating the credit also eases administrative burdens for taxpayers and the Internal Revenue Service, eliminating substantial amounts of recordkeeping, documentation issues, and controversy connected with the historical base-period credit. By increasing the alternative simplified credit from 14 percent to 20 percent and permitting eligible small businesses to claim the credit against AMT liability, H.R. 880 further incentivizes critical research here in the United States.

C. Legislative History

Background

H.R. 880 was introduced on February 11, 2015, and was referred to the Committee on Ways and Means.

Committee action

The Committee on Ways and Means marked up H.R. 880, the American Research and Competitiveness Act of 2015, on February 12, 2015, and ordered the bill, as amended, favorably reported (with a quorum being present).

Committee hearings

The need for a permanent simplified research credit was discussed at no fewer than eight hearings during the 112th and 113th Congresses:

- Full Committee Hearing on Fundamental Tax Reform (January 20, 2011);
- Select Revenue Measures Subcommittee Hearing on Small Businesses and Tax Reform (March 3, 2011);
- Full Committee Hearing on the Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers (May 12, 2011);

• Full Committee Hearing on How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs (May 24, 2011);
• Full Committee Hearing on How Business Tax Reform Can Encourage Job Creation (June 2, 2011);
• Full Committee Hearing on the Interaction of Tax and Financial Accounting on Tax Reform (February 8, 2012);
• Full Committee Hearing on Tax Reform and the U.S. Manufacturing Sector (July 19, 2012); and
• Full Committee Hearing on the Benefits of Permanent Tax Policy for America's Job Creators (April 8, 2014).

II. EXPLANATION OF THE BILL

A. Research Credit Simplified and Made Permanent (sec. 41 of the Code)

PRESENT LAW

General rule

For general research expenditures, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[1] Thus, the research credit is generally available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14-percent rate and a different base amount) may be claimed in lieu of this credit.[2]

A 20-percent research tax credit also is available with respect to the excess of (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.[3] This separate credit computation commonly is referred to as the basic research credit.

Finally, a research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium.[4] This separate credit computation commonly is referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

The research credit, including the basic research credit and the energy research credit, expires for amounts paid or incurred after December 31, 2014.[5]

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[1] Sec. 41(a)(1). Except where otherwise specified, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").
[2] Sec. 41(c)(5).
[3] Sec. 41(a)(2) and (e). The base period for the basic research credit generally extends from 1981 through 1983.
[4] Sec. 41(a)(3).
[5] Sec. 41(h).

Computation of general research credit

The general research tax credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). Special rules apply to all other taxpayers (so called start-up firms).[6] In computing the research credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

Alternative simplified credit

The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years.[7] The rate is reduced to 6 percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.[8] An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary.[9]

Eligible expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf (so-called contract research expenses).[10] Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or Federal laboratory for qualified energy research.

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[6] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. Sec. 41(c)(3)(B).

[7] Sec. 41(c)(5)(A).

[8] Sec. 41(c)(5)(B).

[9] Sec. 41(c)(5)(C).

[10] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. Sec. 41(b)(3)(C).

To be eligible for the credit, the research not only has to satisfy the requirements of section 174, but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors.[11] In addition, research does not qualify for the credit if: (1) conducted after the beginning of commercial production of the business component; (2) related to the adaptation of an existing business component to a particular customer's requirements; (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information; (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control; (5) related to software developed primarily for internal use by the taxpayer; (6) conducted outside the United States, Puerto Rico, or any U.S. possession; (7) in the social sciences, arts, or humanities; or (8) funded by any grant, contract, or otherwise by another person (or government entity).[12]

Relation to deduction

Deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[13] Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed.[14]

Specified credits allowed against alternative minimum tax

For any taxable year, the general business credit (which is the sum of the various business credits) generally may not exceed the excess of the taxpayer's net income tax[15] over the greater of (1) the taxpayer's tentative minimum tax or (2) 25 percent of so much of the taxpayer's net regular tax liability[16] as exceeds $25,000.[17] Any general business credit in excess of this limitation may be carried back one year and forward up to 20 years.[18] The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of the alternative minimum taxable income over an exemption amount.[19] Generally, the tentative minimum tax of a C

[11] Sec. 41(d)(3).
[12] Sec. 41(d)(4).
[13] Sec. 280C(c).
[14] Sec. 280C(c)(3).
[15] The term net income tax means the sum of the regular tax liability and the alternative minimum tax, reduced by the credits allowable under sections 21 through 30D. Sec. 38(c)(1).
[16] The term net regular tax liability means the regular tax liability reduced by the sum of certain nonrefundable personal and other credits. Sec. 38(c)(1).
[17] Sec. 38(c)(1).
[18] Sec. 39(a)(1).
[19] See sec. 55(b). For example, assume a taxpayer has a regular tax of $80,000, a tentative minimum tax of $100,000, and a research credit determined under section 41 of $90,000 for a taxable year (and no other credits). Under present law, the taxpayer's research credit is limited to the excess of $100,000 over the greater of (1) $100,000 or (2) $13,750 (25% of the excess of

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corporation with average annual gross receipts of less than $7.5 million for prior 3-year periods is zero.[20]

In applying the tax liability limitation to a list of "specified credits" that are part of the general business credit, the tentative minimum tax is treated as being zero.[21] Thus, the specified credits generally may offset both regular and alternative minimum tax liability ("AMT").

For taxable years beginning in 2010, an eligible small business was allowed to offset both the regular and AMT liability with the general business credits determined for the taxable year ("eligible small business credits").[22] For this purpose, an eligible small business was, with respect to any taxable year, a corporation, the stock of which was not publicly traded, a partnership, or a sole proprietor, if the average annual gross receipts did not exceed $50 million.[23] Credits determined with respect to a partnership or S corporation were not treated as eligible small business credits by a partner or shareholder unless the partner or shareholder met the gross receipts test for the taxable year in which the credits were treated as current year business credits.[24]

REASONS FOR CHANGE

The Committee acknowledges that research is vital to creating jobs and economic growth. Research is the basis of new products, services, industries, and jobs for the domestic economy. The Committee believes that the temporary nature of the now-expired research credit limits its effectiveness, preventing businesses from making long-term investments in U.S.-based research and related business operations. Additionally, many taxpayers report that the general research credit can be complicated to calculate and that the base period is difficult to determine. The Committee believes that the alternative simplified credit is a more straightforward approach for calculating the research credit and that replacing the general credit with the simplified method would make the research credit more efficient and better achieve its intended purpose of fostering domestic research and experimentation. In addition, the Committee believes that small businesses should have better access to and be able to benefit from the research credit. Therefore, the Committee believes it is appropriate to simplify and make permanent the present-law research credit, as well as allow an eligible small business to claim it against the AMT.

EXPLANATION OF PROVISION

The provision makes permanent the alternative simplified method for calculating the research credit and increases the rate to 20 percent. That is, the research credit is equal to 20 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The

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$80,000 over $25,000). Accordingly, no research credit may be claimed ($100,000 − $100,000 = $0) for the taxable year and the taxpayer's net tax liability is $100,000. The $90,000 research credit may be carried back or forward under the rules applicable to the general business credit.

[20] Sec. 55(e).

[21] See section 38(c)(4)(B) for the list of specified credits, which does not presently include the research credit determined under section 41.

[22] Sec. 38(c)(5)(B).

[23] Sec. 38(c)(5)(C).

[24] Sec. 38(c)(5)(D).

rate is reduced to 10 percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years. The provision repeals the traditional 20-percent research credit calculation method.

The provision also makes permanent the basic research credit and the energy research credit (both with credit rates of 20 percent), and changes the base period for the basic research credit from a fixed period to a three-year rolling average.

The provision also provides that, in the case of an eligible small business (as defined in section 38(c)(5)(C)), the research credit is a specified credit. Thus, the research credits of an eligible small business may offset both regular and AMT liability.[25]

EFFECTIVE DATE

The provision is generally effective for taxable years beginning after December 31, 2014. The provision to make the research credit permanent applies to amounts paid or incurred after December 31, 2014.

III. VOTES OF THE COMMITTEE

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the votes of the Committee on Ways and Means in its consideration of H.R. 880, the American Research and Competitiveness Act of 2015, on February 12, 2015.

The vote on the motion by Mr. Brady to table Mr. Crowley's motion to appeal the ruling of the Chair that the amendment offered by Mr. Crowley was non-germane was agreed to by a roll call vote of 23 yeas to 11 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Ryan	X			Mr. Levin		X	
Mr. Johnson	X			Mr. Rangel		X	
Mr. Brady	X			Mr. McDermott		X	
Mr. Nunes	X			Mr. Lewis		X	
Mr. Tiberi	X			Mr. Neal			
Mr. Reichert	X			Mr. Becerra			
Mr. Boustany	X			Mr. Doggett		X	
Mr. Roskam	X			Mr. Thompson		X	
Mr. Price				Mr. Larson		X	
Mr. Buchanan	X			Mr. Blumenauer			
Mr. Smith (NE)	X			Mr. Kind		X	
Mr. Schock	X			Mr. Pascrell		X	
Ms. Jenkins	X			Mr. Crowley		X	
Mr. Paulsen	X			Mr. Davis		X	
Mr. Marchant	X			Ms. Sanchez			
Ms. Black	X						
Mr. Reed	X						
Mr. Young	X						
Mr. Kelly	X						
Mr. Renacci	X						
Mr. Meehan	X						

[25] Using the above example, under this provision, the limitation would be the excess of $80,000 over the greater of (1) $0 or (2) $13,750. Since $13,750 is greater than $0, the $80,000 would be reduced by $13,750 such that the research credit limitation would be $66,250. Hence, the taxpayer would be able to claim a research credit of $66,250 against its net income tax liability, as well as its AMT liability, which would result in $33,250 of total tax owed ($100,000—$66,250). The remaining $23,750 of its research credit ($90,000—$66,250) may be carried back or forward, as applicable.

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Ms. Noem	X						
Mr. Holding	X						
Mr. Smith (MO)	X						

The Chairman's amendment in the nature of a substitute was adopted by a voice vote (with a quorum being present).

The bill, H.R. 880, was ordered favorably reported as amended by a roll call vote of 23 yeas to 12 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Ryan	X			Mr. Levin		X	
Mr. Johnson	X			Mr. Rangel		X	
Mr. Brady	X			Mr. McDermott		X	
Mr. Nunes	X			Mr. Lewis		X	
Mr. Tiberi	X			Mr. Neal			
Mr. Reichert	X			Mr. Becerra			
Mr. Boustany	X			Mr. Doggett		X	
Mr. Roskam	X			Mr. Thompson		X	
Mr. Price	X			Mr. Larson		X	
Mr. Buchanan	X			Mr. Blumenauer		X	
Mr. Smith (NE)	X			Mr. Kind		X	
Mr. Schock	X			Mr. Pascrell		X	
Ms. Jenkins	X			Mr. Crowley		X	
Mr. Paulsen	X			Mr. Davis		X	
Mr. Marchant	X			Ms. Sanchez			
Ms. Black	X						
Mr. Reed	X						
Mr. Young							
Mr. Kelly	X						
Mr. Renacci	X						
Mr. Meehan	X						
Ms. Noem	X						
Mr. Holding	X						
Mr. Smith (MO)	X						

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 880, as reported.

The bill, as reported, is estimated to have the following effect on Federal budget receipts for fiscal years 2015–2025.

FISCAL YEARS

[Millions of dollars]

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015–20	2015–25
−4,716	−8,768	−11,042	−13,212	−15,270	−17,229	−19,085	−20,824	−22,577	−23,894	−24,989	−70,237	−181,609

NOTE: Details do not add to totals due to rounding.

Pursuant to clause 8 of rule XIII of the Rules of the House of Representatives, the following statement is made by the Joint Committee on Taxation with respect to the provisions of the bill amending the Internal Revenue Code of 1986: the gross budgetary effect (before incorporating macroeconomic effects) in any fiscal year is less than 0.25 percent of the current projected gross domestic product of the United States for that fiscal year; therefore, the bill is not "major legislation" for purposes of requiring that the estimate include the budgetary effects of changes in economic output, employment, capital stock and other macroeconomic variables.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing tax provision involves increased tax expenditures. (See amounts in table in Part IV.A., above.)

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, February 19, 2015.

Hon. Paul Ryan,
Chairman, Committee Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 880, the American Research and Competitiveness Act of 2015.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Logan Timmerhoff.

Sincerely,

Robert A. Sunshine
(For Douglas W. Elmendorf, Director).

Enclosure.

H.R. 880—American Research and Competitiveness Act of 2015

H.R. 880 would amend the Internal Revenue Code to make permanent a modified version of the tax credit for qualified research expenses that expired at the end of 2014. The bill would not extend the traditional calculation method and its associated 20 percent credit. It would, however, make permanent the "alternative simplified method" for calculating the tax credit for qualified research expenses and generally increase the associated credit to 20 percent of those expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. Among other changes, the bill also would make permanent a tax credit for basic research and energy research and would change the base pe-

riod for the basic research credit from a fixed period to a three-year rolling average.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting H.R. 880 would reduce revenues, thus increasing federal deficits, by about $182 billion over the 2015–2025 period.

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending and revenues. Enacting H.R. 880 would result in revenue losses in each year beginning in 2015. The estimated increases in the deficit are shown in the following table.

JCT has determined that the bill contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act.

The CBO staff contact for this estimate is Logan Timmerhoff. The estimate was approved by David Weiner, Assistant Director for Tax Analysis.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 880, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON FEBRUARY 12, 2015

	By fiscal year, in millions of dollars—												
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015–2020	2015–2025
NET INCREASE IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	4,716	8,768	11,042	13,212	15,270	17,229	19,085	20,824	22,577	23,894	24,989	70,237	181,609

Source: Staff of the Joint Committee on Taxation.
Note: Components may not sum to totals because of rounding.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was as a result of the Committee's review of the provisions of H.R. 880 that the Committee concluded that it is appropriate to report the bill, as amended, favorably to the House of Representatives with the recommendation that the bill do pass.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4). The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. Applicability of House Rule XXI 5(b)

Rule XXI 5(b) of the Rules of the House of Representatives provides, in part, that "A bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase may not be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting, a quorum being present." The Committee has carefully reviewed the bill, and states that the bill does not involve any Federal income tax rate increases within the meaning of the rule.

E. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread appli-

cability" to individuals or small businesses, within the meaning of the rule.

F. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

G. Duplication of Federal Programs

In compliance with Sec. 3(g)(2) of H. Res. 5 (114th Congress), the Committee states that no provision of the bill establishes or reauthorizes a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Public Law 95–220, as amended by Public Law 98–169). The Committee also states that the Government Accountability Office has included the research tax credit in a report to Congress pursuant to section 21 of Public Law 111–139.

H. Disclosure of Directed Rule Makings

In compliance with Sec. 3(i) of H. Res. 5 (114th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rule makings within the meaning of such section.

VI. CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

A. Text of Existing Law Amended or Repealed by the Bill, as Reported

In compliance with clause 3(e)(1)(A) of rule XIII of the Rules of the House of Representatives, the text of each section proposed to be amended or repealed by the bill, as reported, is shown below:

INTERNAL REVENUE CODE OF 1986

* * * * * * *

Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter A—Determination of Tax Liability

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PART IV—CREDITS AGAINST TAX

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Subpart D—Business Related Credits

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SEC. 38. GENERAL BUSINESS CREDIT.

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

(1) the business credit carryforwards carried to such taxable year,

(2) the amount of the current year business credit, plus

(3) the business credit carrybacks carried to such taxable year.

(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

(1) the investment credit determined under section 46,

(2) the work opportunity credit determined under section 51(a),

(3) the alcohol fuels credit determined under section 40(a),

(4) the research credit determined under section 41(a),

(5) the low-income housing credit determined under section 42(a),

(6) the enhanced oil recovery credit under section 43(a),

(7) in the case of an eligible small business (as defined in section 44(b)), the disabled access credit determined under section 44(a),

(8) the renewable electricity production credit under section 45(a),

(9) the empowerment zone employment credit determined under section 1396(a),

(10) the Indian employment credit as determined under section 45A(a),

(11) the employer social security credit determined under section 45B(a),

(12) the orphan drug credit determined under section 45C(a),

(13) the new markets tax credit determined under section 45D(a),

(14) in the case of an eligible employer (as defined in section 45E(c)), the small employer pension plan startup cost credit determined under section 45E(a),

(15) the employer-provided child care credit determined under section 45F(a),

(16) the railroad track maintenance credit determined under section 45G(a),

(17) the biodiesel fuels credit determined under section 40A(a),

(18) the low sulfur diesel fuel production credit determined under section 45H(a),

(19) the marginal oil and gas well production credit determined under section 45I(a),

(20) the distilled spirits credit determined under section 5011(a),

(21) the advanced nuclear power facility production credit determined under section 45J(a),

(22) the nonconventional source production credit determined under section 45K(a),

(23) the new energy efficient home credit determined under section 45L(a),

(24) the energy efficient appliance credit determined under section 45M(a),

(25) the portion of the alternative motor vehicle credit to which section 30B(g)(1) applies,

(26) the portion of the alternative fuel vehicle refueling property credit to which section 30C(d)(1) applies,

(27) the Hurricane Katrina housing credit determined under section 1400P(b),

(28) the Hurricane Katrina employee retention credit determined under section 1400R(a),

(29) the Hurricane Rita employee retention credit determined under section 1400R(b),

(30) the Hurricane Wilma employee retention credit determined under section 1400R(c),

(31) the mine rescue team training credit determined under section 45N(a),

(32) in the case of an eligible agricultural business (as defined in section 45O(e)), the agricultural chemicals security credit determined under section 45O(a),

(33) the differential wage payment credit determined under section 45P(a),

(34) the carbon dioxide sequestration credit determined under section 45Q(a)

(35) the portion of the new qualified plug-in electric drive motor vehicle credit to which section 30D(c)(1) applies, plus

(36) the small employer health insurance credit determined under section 45R.

(c) LIMITATION BASED ON AMOUNT OF TAX.—

(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess (if any) of the taxpayer's net income tax over the greater of—

(A) the tentative minimum tax for the taxable year, or

(B) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.

For purposes of the preceding sentence, the term "net income tax" means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of this part, and the term "net regular tax liability" means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

(2) EMPOWERMENT ZONE EMPLOYMENT CREDIT MAY OFFSET 25 PERCENT OF MINIMUM TAX.—

(A) IN GENERAL.—In the case of the empowerment zone employment credit—

(i) this section and section 39 shall be applied separately with respect to such credit, and

(ii) for purposes of applying paragraph (1) to such credit—

(I) 75 percent of the tentative minimum tax shall be substituted for the tentative minimum tax under subparagraph (A) thereof, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the empowerment zone employment credit, the New York Liberty Zone business employee credit, the eligible small business credits, and the specified credits).

(B) EMPOWERMENT ZONE EMPLOYMENT CREDIT.—For purposes of this paragraph, the term "empowerment zone employment credit" means the portion of the credit under subsection (a) which is attributable to the credit determined under section 1396 (relating to empowerment zone employment credit).

(3) SPECIAL RULES FOR NEW YORK LIBERTY ZONE BUSINESS EMPLOYEE CREDIT.—

(A) IN GENERAL.—In the case of the New York Liberty Zone business employee credit—

(i) this section and section 39 shall be applied separately with respect to such credit, and

(ii) in applying paragraph (1) to such credit—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the New York Liberty Zone business employee credit, the eligible small business credits, and the specified credits).

(B) NEW YORK LIBERTY ZONE BUSINESS EMPLOYEE CREDIT.—For purposes of this subsection, the term "New York Liberty Zone business employee credit" means the portion of work opportunity credit under section 51 determined under section 1400L(a).

(4) SPECIAL RULES FOR SPECIFIED CREDITS.—

(A) IN GENERAL.—In the case of specified credits—

(i) this section and section 39 shall be applied separately with respect to such credits, and

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the eligible small business credits and the specified credits).

(B) SPECIFIED CREDITS.—For purposes of this subsection, the term "specified credits" means—

(i) for taxable years beginning after December 31, 2004, the credit determined under section 40,

(ii) the credit determined under section 42 to the extent attributable to buildings placed in service after December 31, 2007,

(iii) the credit determined under section 45 to the extent that such credit is attributable to electricity or refined coal produced—

(I) at a facility which is originally placed in service after the date of the enactment of this paragraph, and

(II) during the 4-year period beginning on the date that such facility was originally placed in service,

(iv) the credit determined under section 45B,

(v) the credit determined under section 45G,

(vi) the credit determined under section 45R,

(vii) the credit determined under section 46 to the extent that such credit is attributable to the energy credit determined under section 48,

(viii) the credit determined under section 46 to the extent that such credit is attributable to the rehabilitation credit under section 47, but only with respect to qualified rehabilitation expenditures properly taken into account for periods after December 31, 2007, and

(ix) the credit determined under section 51.

(5) SPECIAL RULES FOR ELIGIBLE SMALL BUSINESS CREDITS IN 2010.—

(A) IN GENERAL.—In the case of eligible small business credits determined in taxable years beginning in 2010—

(i) this section and section 39 shall be applied separately with respect to such credits, and

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the eligible small business credits).

(B) ELIGIBLE SMALL BUSINESS CREDITS.—For purposes of this subsection, the term "eligible small business credits" means the sum of the credits listed in subsection (b) which are determined for the taxable year with respect to an eligible small business. Such credits shall not be taken into account under paragraph (2), (3), or (4).

(C) ELIGIBLE SMALL BUSINESS.—For purposes of this subsection, the term "eligible small business" means, with respect to any taxable year—

(i) a corporation the stock of which is not publicly traded,

(ii) a partnership, or

(iii) a sole proprietorship, if the average annual gross receipts of such corporation, partnership, or sole proprietorship for the 3-taxable-year period preceding such taxable year does not exceed $50,000,000. For purposes of applying the test under the preceding sentence, rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.

(D) TREATMENT OF PARTNERS AND S CORPORATION SHAREHOLDERS.—Credits determined with respect to a partnership or S corporation shall not be treated as eligible small business credits by any partner or shareholder unless such partner or shareholder meets the gross receipts test under subparagraph (C) for the taxable year in which such credits are treated as current year business credits.

(6) SPECIAL RULES.—

(A) MARRIED INDIVIDUALS.—In the case of a husband or wife who files a separate return, the amount specified under subparagraph (B) of paragraph (1) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no business credit carryforward or carryback to, and has no current year business credit for, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(B) CONTROLLED GROUPS.—In the case of a controlled group, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term "controlled group" has the meaning given to such term by section 1563(a).

(C) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(1) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), the $25,000 amount specified under subparagraph (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2) (as so in effect) of such amount.

(D) ESTATES AND TRUSTS.—In the case of an estate or trust, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced to an amount which bears the same ratio to $25,000 as the portion of the income of the estate or trust which is not allocated to beneficiaries bears to the total income of the estate or trust.

(d) ORDERING RULES.—For purposes of any provision of this title where it is necessary to ascertain the extent to which the credits determined under any section referred to in subsection (b) are used in a taxable year or as a carryback or carryforward—

(1) IN GENERAL.—The order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b) as of the close of the taxable year in which the credit is used.

(2) COMPONENTS OF INVESTMENT CREDIT.—The order in which the credits listed in section 46 are used shall be determined on the basis of the order in which such credits are listed in section 46 as of the close of the taxable year in which the credit is used.

* * * * * * *

SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

(a) GENERAL RULE.—For purposes of section 38, the 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,

(2) 20 percent of the basic research payments determined under subsection (e)(1)(A), and

(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

(b) QUALIFIED RESEARCH EXPENSES.—For purposes of this section—

(1) QUALIFIED RESEARCH EXPENSES.—The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer—

(A) in-house research expenses, and

(B) contract research expenses.

(2) IN-HOUSE RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "in-house research expenses" means—

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) receives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) QUALIFIED SERVICES.—The term "qualified services" means services consisting of—

(i) engaging in qualified research, or

(ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause (i) or (ii), the term "qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) SUPPLIES.—The term "supplies" means any tangible property other than—

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) WAGES.—

(i) IN GENERAL.—The term "wages" has the meaning given such term by section 3401(a).

(ii) SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) EXCLUSION FOR WAGES TO WHICH WORK OPPORTUNITY CREDIT APPLIES.—The term "wages" shall not include any amount taken into account in determining the work opportunity credit under section 51(a).

(3) CONTRACT RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) PREPAID AMOUNTS.—If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(C) AMOUNTS PAID TO CERTAIN RESEARCH CONSORTIA.—

(i) IN GENERAL.—Subparagraph (A) shall be applied by substituting "75 percent" for "65 percent" with respect to amounts paid or incurred by the taxpayer to a qualified research consortium for qualified research on behalf of the taxpayer and 1 or more unrelated taxpayers. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related taxpayers.

(ii) QUALIFIED RESEARCH CONSORTIUM.—The term "qualified research consortium" means any organization which—

(I) is described in section 501(c)(3) or 501(c)(6) and is exempt from tax under section 501(a),

(II) is organized and operated primarily to conduct scientific research, and

(III) is not a private foundation.

(D) AMOUNTS PAID TO ELIGIBLE SMALL BUSINESSES, UNIVERSITIES, AND FEDERAL LABORATORIES.—

(i) IN GENERAL.—In the case of amounts paid by the taxpayer to—

(I) an eligible small business,

(II) an institution of higher education (as defined in section 3304(f)), or

(III) an organization which is a Federal laboratory,

for qualified research which is energy research, subparagraph (A) shall be applied by substituting "100 percent" for "65 percent".

(ii) ELIGIBLE SMALL BUSINESS.—For purposes of this subparagraph, the term "eligible small business"

means a small business with respect to which the taxpayer does not own (within the meaning of section 318) 50 percent or more of—

(I) in the case of a corporation, the outstanding stock of the corporation (either by vote or value), and

(II) in the case of a small business which is not a corporation, the capital and profits interests of the small business.

(iii) SMALL BUSINESS.—For purposes of this subparagraph—

(I) IN GENERAL.—The term "small business" means, with respect to any calendar year, any person if the annual average number of employees employed by such person during either of the 2 preceding calendar years was 500 or fewer. For purposes of the preceding sentence, a preceding calendar year may be taken into account only if the person was in existence throughout the year.

(II) STARTUPS, CONTROLLED GROUPS, AND PREDECESSORS.—Rules similar to the rules of subparagraphs (B) and (D) of section 220(c)(4) shall apply for purposes of this clause.

(iv) FEDERAL LABORATORY.—For purposes of this subparagraph, the term "Federal laboratory" has the meaning given such term by section 4(6) of the Stevenson-Wydler Technology Innovation Act of 1980 (15 U.S.C. 3703(6)), as in effect on the date of the enactment of the Energy Tax Incentives Act of 2005.

(4) TRADE OR BUSINESS REQUIREMENT DISREGARDED FOR IN-HOUSE RESEARCH EXPENSES OF CERTAIN STARTUP VENTURES.—In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business—

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

(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 (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 tax-

payer 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.

(B) START-UP COMPANIES.—

(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The fixed-base percentage shall be determined under this subparagraph if—

(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

(II) there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

(ii) FIXED-BASE PERCENTAGE.—In a case to which this subparagraph applies, the fixed-base percentage is—

(I) 3 percent for each of the taxpayer's 1st 5 taxable years beginning after December 31, 1993, for which the taxpayer has qualified research expenses,

(II) in the case of the taxpayer's 6th such taxable year, 1/6 of the percentage which the aggregate qualified research expenses of the taxpayer for the 4th and 5th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(III) in the case of the taxpayer's 7th such taxable year, 1/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th and 6th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(IV) in the case of the taxpayer's 8th such taxable year, 1/2 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, and 7th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(V) in the case of the taxpayer's 9th such taxable year, 2/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, and 8th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(VI) in the case of the taxpayer's 10th such taxable year, 5/6 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, 8th, and 9th such taxable years is of the aggregate gross receipts of the taxpayer for such years, and

(VII) for taxable years thereafter, the percentage which the aggregate qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through the 10th such

taxable years is of the aggregate gross receipts of the taxpayer for such selected years.

(iii) TREATMENT OF DE MINIMIS AMOUNTS OF GROSS RECEIPTS AND QUALIFIED RESEARCH EXPENSES.—The Secretary may prescribe regulations providing that de minimis amounts of gross receipts and qualified research expenses shall be disregarded under clauses (i) and (ii).

(C) MAXIMUM FIXED-BASE PERCENTAGE.—In no event shall the fixed-base percentage exceed 16 percent.

(D) ROUNDING.—The percentages determined under subparagraphs (A) and (B)(ii) shall be rounded to the nearest 1/100th of 1 percent.

(4) ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to the sum of—

(i) 3 percent of so much of the qualified research expenses for the taxable year as exceeds 1 percent of the average described in subsection (c)(1)(B) but does not exceed 1.5 percent of such average,

(ii) 4 percent of so much of such expenses as exceeds 1.5 percent of such average but does not exceed 2 percent of such average, and

(iii) 5 percent of so much of such expenses as exceeds 2 percent of such average.

(B) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

(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.

(B) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAXABLE YEARS.—

(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

(ii) CREDIT RATE.—The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

(C) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. An election under this paragraph may not

be made for any taxable year to which an election under paragraph (4) applies.

(6) CONSISTENT TREATMENT OF EXPENSES REQUIRED.—

(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

(7) GROSS RECEIPTS.—For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(d) QUALIFIED RESEARCH DEFINED.—For purposes of this section—

(1) IN GENERAL.—The term "qualified research" means research—

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) TESTS TO BE APPLIED SEPARATELY TO EACH BUSINESS COMPONENT.—For purposes of this subsection—

(A) IN GENERAL.—Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B) BUSINESS COMPONENT DEFINED.—The term "business component" means any product, process, computer software, technique, formula, or invention which is to be—

(i) held for sale, lease, or license, or

(ii) used by the taxpayer in a trade or business of the taxpayer.

(C) SPECIAL RULE FOR PRODUCTION PROCESSES.—Any plant process, machinery, or technique for commercial production of a business component shall be treated as a sepa-

rate business component (and not as part of the business component being produced).

(3) PURPOSES FOR WHICH RESEARCH MAY QUALIFY FOR CREDIT.—For purposes of paragraph (1)(C)—

(A) IN GENERAL.—Research shall be treated as conducted for a purpose described in this paragraph if it relates to—

(i) a new or improved function,

(ii) performance, or

(iii) reliability or quality.

(B) CERTAIN PURPOSES NOT QUALIFIED.—Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) ACTIVITIES FOR WHICH CREDIT NOT ALLOWED.—The term "qualified research" shall not include any of the following:

(A) RESEARCH AFTER COMMERCIAL PRODUCTION.—Any research conducted after the beginning of commercial production of the business component.

(B) ADAPTATION OF EXISTING BUSINESS COMPONENTS.—Any research related to the adaptation of an existing business component to a particular customer's requirement or need.

(C) DUPLICATION OF EXISTING BUSINESS COMPONENT.—Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) SURVEYS, STUDIES, ETC..—Any—

(i) efficiency survey,

(ii) activity relating to management function or technique,

(iii) market research, testing, or development (including advertising or promotions),

(iv) routine data collection, or

(v) routine or ordinary testing or inspection for quality control.

(E) COMPUTER SOFTWARE.—Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in—

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) FOREIGN RESEARCH.—Any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(G) SOCIAL SCIENCES, ETC..—Any research in the social sciences, arts, or humanities.

(H) FUNDED RESEARCH.—Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

(e) CREDIT ALLOWABLE WITH RESPECT TO CERTAIN PAYMENTS TO QUALIFIED ORGANIZATIONS FOR BASIC RESEARCH.—For purposes of this section—

(1) IN GENERAL.—In the case of any taxpayer who makes basic research payments for any taxable year—

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

(i) such basic research payments, over

(ii) the qualified organization base period amount, and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

(2) BASIC RESEARCH PAYMENTS DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

(B) EXCEPTION TO REQUIREMENT THAT RESEARCH BE PERFORMED BY THE ORGANIZATION.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

(3) QUALIFIED ORGANIZATION BASE PERIOD AMOUNT.—For purposes of this subsection, the term "qualified organization base period amount" means an amount equal to the sum of—

(A) the minimum basic research amount, plus

(B) the maintenance-of-effort amount.

(4) MINIMUM BASIC RESEARCH AMOUNT.—For purposes of this subsection—

(A) IN GENERAL.—The term "minimum basic research amount" means an amount equal to the greater of—

(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for—

(I) any in-house research expenses, and

(II) any contract research expenses, or

(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

(B) FLOOR AMOUNT.—Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

(5) MAINTENANCE-OF-EFFORT AMOUNT.—For purposes of this subsection—

(A) IN GENERAL.—The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of—

(i) an amount equal to—

(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over (ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

(B) NONDESIGNATED UNIVERSITY CONTRIBUTIONS.—For purposes of this paragraph, the term "nondesignated university contribution" means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A)—

(i) for which a deduction was allowable under section 170, and

(ii) which was not taken into account—

(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

(II) as a basic research payment for purposes of this section.

(C) COST-OF-LIVING ADJUSTMENT DEFINED.—

(i) IN GENERAL.—The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3), by substituting "calendar year 1987" for "calendar year 1992" in subparagraph (B) thereof.

(ii) SPECIAL RULE WHERE BASE PERIOD ENDS IN A CALENDAR YEAR OTHER THAN 1983 OR 1984.—If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(B) shall, or purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 1992. Such substitution shall be in lieu of the substitution under clause (i).

(6) QUALIFIED ORGANIZATION.—For purposes of this subsection, the term "qualified organization" means any of the following organizations:

(A) EDUCATIONAL INSTITUTIONS.—Any educational organization which—

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii).

(B) CERTAIN SCIENTIFIC RESEARCH ORGANIZATIONS.—Any organization not described in subparagraph (A) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a),

(ii) is organized and operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) SCIENTIFIC TAX-EXEMPT ORGANIZATIONS.—Any organization which—

(i) is described in—

(I) section 501(c)(3) (other than a private foundation), or

(II) section 501(c)(6),

(ii) is exempt from tax under section 501(a),

(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends—

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A).

(D) CERTAIN GRANT ORGANIZATIONS.—Any organization not described in subparagraph (B) or (C) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

(7) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) BASIC RESEARCH.—The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include—

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts, or humanities.

(B) BASE PERIOD.—The term "base period" means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

(C) EXCLUSION FROM INCREMENTAL CREDIT CALCULATION.—For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)—

(i) shall not be treated as qualified research expenses under subsection (a)(1)(A), and

(ii) shall not be included in the computation of base amount under subsection (a)(1)(B).

(D) TRADE OR BUSINESS QUALIFICATION.—For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

(E) CERTAIN CORPORATIONS NOT ELIGIBLE.—The term "corporation" shall not include—

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), or

(iii) a service organization (as defined in section 414(m)(3)).

(f) SPECIAL RULES.—For purposes of this section—

(1) AGGREGATION OF EXPENDITURES.—

(A) CONTROLLED GROUP OF CORPORATIONS.—In determining the amount of the credit under this section—

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.

(B) COMMON CONTROL.—Under regulations prescribed by the Secretary, in determining the amount of the credit under this section—

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by all such persons under common control for purposes of this section.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(2) ALLOCATIONS.—

(A) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) ALLOCATION IN THE CASE OF PARTNERSHIPS.—In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) ADJUSTMENTS FOR CERTAIN ACQUISITIONS, ETC..—Under regulations prescribed by the Secretary—

(A) ACQUISITIONS.—

(i) IN GENERAL.—If a person acquires the major portion of either a trade or business or a separate unit of a trade or business (hereinafter in this paragraph re-

ferred to as the "acquired business") of another person (hereinafter in this paragraph referred to as the "predecessor"), then the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period shall be increased by the amount determined under clause (ii), and the gross receipts of the acquiring person for such period shall be increased by the amount determined under clause (iii).

(ii) AMOUNT DETERMINED WITH RESPECT TO QUALIFIED RESEARCH EXPENSES.—The amount determined under this clause is—

(I) for purposes of applying this section for the taxable year in which such acquisition is made, the acquisition year amount, and

(II) for purposes of applying this section for any taxable year after the taxable year in which such acquisition is made, the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period.

(iii) AMOUNT DETERMINED WITH RESPECT TO GROSS RECEIPTS.—The amount determined under this clause is the amount which would be determined under clause (ii) if "the gross receipts of" were substituted for "the qualified research expenses paid or incurred by" each place it appears in clauses (ii) and (iv).

(iv) ACQUISITION YEAR AMOUNT.—For purposes of clause (ii), the acquisition year amount is the amount equal to the product of—

(I) the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period, and

(II) the number of days in the period beginning on the date of the acquisition and ending on the last day of the taxable year in which the acquisition is made,

divided by the number of days in the acquiring person's taxable year.

(v) SPECIAL RULES FOR COORDINATING TAXABLE YEARS.—In the case of an acquiring person and a predecessor whose taxable years do not begin on the same date—

(I) each reference to a taxable year in clauses (ii) and (iv) shall refer to the appropriate taxable year of the acquiring person,

(II) the qualified research expenses paid or incurred by the predecessor, and the gross receipts of the predecessor, during each taxable year of the predecessor any portion of which is part of the measurement period shall be allocated equally among the days of such taxable year,

(III) the amount of such qualified research expenses taken into account under clauses (ii) and (iv) with respect to a taxable year of the acquiring

person shall be equal to the total of the expenses attributable under subclause (II) to the days occurring during such taxable year, and

(IV) the amount of such gross receipts taken into account under clause (iii) with respect to a taxable year of the acquiring person shall be equal to the total of the gross receipts attributable under subclause (II) to the days occurring during such taxable year.

(vi) MEASUREMENT PERIOD.—For purposes of this subparagraph, the term "measurement period" means, with respect to the taxable year of the acquiring person for which the credit is determined, any period of the acquiring person preceding such taxable year which is taken into account for purposes of determining the credit for such year.

(B) DISPOSITIONS.—If the predecessor furnished to the acquiring person such information as is necessary for the application of subparagraph (A), then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by, and the gross receipts of, the predecessor during the measurement period (as defined in subparagraph (A)(vi), determined by substituting "predecessor" for "acquiring person" each place it appears) shall be reduced by—

(i) in the case of the taxable year in which such disposition is made, an amount equal to the product of—

(I) the qualified research expenses paid or incurred by, or gross receipts of, the predecessor with respect to the acquired business during the measurement period (as so defined and so determined), and

(II) the number of days in the period beginning on the date of acquisition (as determined for purposes of subparagraph (A)(iv)(II)) and ending on the last day of the taxable year of the predecessor in which the disposition is made,

divided by the number of days in the taxable year of the predecessor, and

(ii) in the case of any taxable year ending after the taxable year in which such disposition is made, the amount described in clause (i)(I).

(C) CERTAIN REIMBURSEMENTS TAKEN INTO ACCOUNT IN DETERMINING FIXED-BASE PERCENTAGE.—If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of—

(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph.

(4) SHORT TAXABLE YEARS.—In the case of any short taxable year, qualified research expenses and gross receipts shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) CONTROLLED GROUP OF CORPORATIONS.—The term "controlled group of corporations" has the same meaning given to such term by section 1563(a), except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(6) ENERGY RESEARCH CONSORTIUM.—

(A) IN GENERAL.—The term "energy research consortium" means any organization—

(i) which is—

(I) described in section 501(c)(3) and is exempt from tax under section 501(a) and is organized and operated primarily to conduct energy research, or

(II) organized and operated primarily to conduct energy research in the public interest (within the meaning of section 501(c)(3)),

(ii) which is not a private foundation,

(iii) to which at least 5 unrelated persons paid or incurred during the calendar year in which the taxable year of the organization begins amounts (including as contributions) to such organization for energy research, and

(iv) to which no single person paid or incurred (including as contributions) during such calendar year an amount equal to more than 50 percent of the total amounts received by such organization during such calendar year for energy research.

(B) TREATMENT OF PERSONS.—All persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related persons for purposes of subparagraph (A)(iii) and as a single person for purposes of subparagraph (A)(iv).

(C) FOREIGN RESEARCH.—For purposes of subsection (a)(3), amounts paid or incurred for any energy research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States shall not be taken into account.

(D) DENIAL OF DOUBLE BENEFIT.—Any amount taken into account under subsection (a)(3) shall not be taken into account under paragraph (1) or (2) of subsection (a).

(E) ENERGY RESEARCH.—The term "energy research" does not include any research which is not qualified research.

(g) SPECIAL RULE FOR PASS-THRU OF CREDIT.—In the case of an individual who—

(1) owns an interest in an unincorporated trade or business,

(2) is a partner in a partnership,

(3) is a beneficiary of an estate or trust, or

(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39.

(h) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred after December 31, 2014.

(2) TERMINATION OF ALTERNATIVE INCREMENTAL CREDIT.—No election under subsection (c)(4) shall apply to taxable years beginning after December 31, 2008.

(2) COMPUTATION FOR TAXABLE YEAR IN WHICH CREDIT TERMINATES.—In the case of any taxable year with respect to which this section applies to a number of days which is less than the total number of days in such taxable year—

(A) the amount determined under subsection (c)(1)(B) with respect to such taxable year shall be the amount which bears the same ratio to such amount (determined without regard to this paragraph) as the number of days in such taxable year to which this section applies bears to the total number of days in such taxable year, and

(B) for purposes of subsection (c)(5), the average qualified research expenses for the preceding 3 taxable years shall be the amount which bears the same ratio to such average qualified research expenses (determined without regard to this paragraph) as the number of days in such taxable year to which this section applies bears to the total number of days in such taxable year.

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SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) GENERAL RULE.—For purposes of section 38, the credit determined under this section for the taxable year is an amount equal to 50 percent of the qualified clinical testing expenses for the taxable year.

(b) QUALIFIED CLINICAL TESTING EXPENSES.—For purposes of this section—

(1) QUALIFIED CLINICAL TESTING EXPENSES.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term "qualified clinical testing expenses" means the amounts which are paid or incurred by the taxpayer during the taxable year which would be described in subsection (b) of section 41 if such subsection were applied with the modifications set forth in subparagraph (B).

(B) MODIFICATIONS.—For purposes of subparagraph (A), subsection (b) of section 41 shall be applied—

(i) by substituting "clinical testing" for "qualified research" each place it appears in paragraphs (2) and (3) of such subsection, and

(ii) by substituting "100 percent" for "65 percent" in paragraph (3)(A) of such subsection.

(C) EXCLUSION FOR AMOUNTS FUNDED BY GRANTS, ETC.—The term "qualified clinical testing expenses" shall not include any amount to the extent such amount is funded by any grant, contract, or otherwise by another person (or any governmental entity).

(D) SPECIAL RULE.—If section 41 is not in effect for any period, such section shall be deemed to remain in effect for such period for purposes of this paragraph.

(2) CLINICAL TESTING.—

(A) IN GENERAL.—The term "clinical testing" means any human clinical testing—

(i) which is carried out under an exemption for a drug being tested for a rare disease or condition under section 505(i) of the Federal Food, Drug, and Cosmetic Act (or regulations issued under such section),

(ii) which occurs—

(I) after the date such drug is designated under section 526 of such Act, and

(II) before the date on which an application with respect to such drug is approved under section 505(b) of such Act or, if the drug is a biological product, before the date on which a license for such drug is issued under section 351 of the Public Health Service Act; and

(iii) which is conducted by or on behalf of the taxpayer to whom the designation under such section 526 applies.

(B) TESTING MUST BE RELATED TO USE FOR RARE DISEASE OR CONDITION.—Human clinical testing shall be taken into account under subparagraph (A) only to the extent such testing is related to the use of a drug for the rare disease or condition for which it was designated under section 526 of the Federal Food, Drug, and Cosmetic Act.

(c) COORDINATION WITH CREDIT FOR INCREASING RESEARCH EXPENDITURES.—

(1) IN GENERAL.—Except as provided in paragraph (2), any qualified clinical testing expenses for a taxable year to which an election under this section applies shall not be taken into account for purposes of determining the credit allowable under section 41 for such taxable year.

(2) EXPENSES INCLUDED IN DETERMINING BASE PERIOD RESEARCH EXPENSES.—Any qualified clinical testing expenses for

any taxable year which are qualified research expenses (within the meaning of section 41(b)) shall be taken into account in determining base period research expenses for purposes of applying section 41 to subsequent taxable years.

(d) DEFINITION AND SPECIAL RULES.—

(1) RARE DISEASE OR CONDITION.—For purposes of this section, the term "rare disease or condition" means any disease or condition which—

(A) affects less than 200,000 persons in the United States, or

(B) affects more than 200,000 persons in the United States but for which there is no reasonable expectation that the cost of developing and making available in the United States a drug for such disease or condition will be recovered from sales in the United States of such drug.

Determinations under the preceding sentence with respect to any drug shall be made on the basis of the facts and circumstances as of the date such drug is designated under section 526 of the Federal Food, Drug, and Cosmetic Act.

(2) SPECIAL LIMITATIONS ON FOREIGN TESTING.—

(A) IN GENERAL.—No credit shall be allowed under this section with respect to any clinical testing conducted outside the United States unless—

(i) such testing is conducted outside the United States because there is an insufficient testing population in the United States, and

(ii) such testing is conducted by a United States person or by any other person who is not related to the taxpayer to whom the designation under section 526 of the Federal Food, Drug, and Cosmetic Act applies.

(B) SPECIAL LIMITATION FOR CORPORATIONS TO WHICH SECTION 936 APPLIES.—No credit shall be allowed under this section with respect to any clinical testing conducted by a corporation to which an election under section 936 applies.

(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (1) and (2) of section 41(f) shall apply for purposes of this section.

(4) ELECTION.—This section shall apply to any taxpayer for any taxable year only if such taxpayer elects (at such time and in such manner as the Secretary may by regulations prescribe) to have this section apply for such taxable year.

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Subchapter B—Computation of Taxable Income

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PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 280C. CERTAIN EXPENSES FOR WHICH CREDITS ARE ALLOWABLE.

(a) RULE FOR EMPLOYMENT CREDITS.—No deduction shall be allowed for that portion of the wages or salaries paid or incurred for

the taxable year which is equal to the sum of the credits determined for the taxable year under sections 45A(a), 45P(a), 51(a), and 1396(a), 1400P(b), and 1400R. In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 52(a)) or a trade or business which is treated as being under common control with other trades or businesses (within the meaning of section 52(b)), this subsection shall be applied under rules prescribed by the Secretary similar to the rules applicable under subsections (a) and (b) of section 52.

(b) CREDIT FOR QUALIFIED CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified clinical testing expenses (as defined in section 45C(b)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—If—

(A) the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)), exceeds

(B) the amount allowable as a deduction for the taxable year for qualified clinical testing expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) CONTROLLED GROUPS.—In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 41(f)(5)) or a trade or business which is treated as being under common control with other trades or business (within the meaning of section 41(f)(1)(B)), this subsection shall be applied under rules prescribed by the Secretary similar to the rules applicable under subparagraphs (A) and (B) of section 41(f)(1).

(c) CREDIT FOR INCREASING RESEARCH ACTIVITIES.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified research expenses (as defined in section 41(b)) or basic research expenses (as defined in section 41(e)(2)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for such taxable year under section 41(a).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—If—

(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

(B) the amount allowable as a deduction for such taxable year for qualified research expenses or basic research expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) ELECTION OF REDUCED CREDIT.—

(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

(i) paragraphs (1) and (2) shall not apply, and

(ii) the amount of the credit under section 41(a) shall be the amount determined under subparagraph (B).

(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

(i) the amount of credit determined under section 41(a) without regard to this paragraph, over

(ii) the product of—

(I) the amount described in clause (i), and

(II) the maximum rate of tax under section 11(b)(1).

(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary may prescribe. Such an election, once made, shall be irrevocable.

(4) CONTROLLED GROUPS.—Paragraph (3) of subsection (b) shall apply for purposes of this subsection.

(d) CREDIT FOR LOW SULFUR DIESEL FUEL PRODUCTION.—The deductions otherwise allowed under this chapter for the taxable year shall be reduced by the amount of the credit determined for the taxable year under section 45H(a).

(e) MINE RESCUE TEAM TRAINING CREDIT.—No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for the taxable year under section 45N(a).

(f) CREDIT FOR SECURITY OF AGRICULTURAL CHEMICALS.—No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction taken into account in determining the credit under section 45O for the taxable year which is equal to the amount of the credit determined for such taxable year under section 45O(a).

(g) CREDIT FOR HEALTH INSURANCE PREMIUMS.—

No deduction shall be allowed for the portion of the premiums paid by the taxpayer for coverage of 1 or more individuals under a qualified health plan which is equal to the amount of the credit determined for the taxable year under section 36B(a) with respect to such premiums.

(h) CREDIT FOR EMPLOYEE HEALTH INSURANCE EXPENSES OF SMALL EMPLOYERS.—No deduction shall be allowed for that portion of the premiums for qualified health plans (as defined in section 1301(a) of the Patient Protection and Affordable Care Act), or for health insurance coverage in the case of taxable years beginning in 2010, 2011, 2012, or 2013, paid by an employer which is equal to the amount of the credit determined under section 45R(a) with respect to the premiums.

(g) QUALIFYING THERAPEUTIC DISCOVERY PROJECT CREDIT.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified investment (as defined in section 48D(b))

otherwise allowable as a deduction for the taxable year which—

(A) would be qualified research expenses (as defined in section 41(b)), basic research expenses (as defined in section 41(e)(2)), or qualified clinical testing expenses (as defined in section 45C(b)) if the credit under section 41 or section 45C were allowed with respect to such expenses for such taxable year, and

(B) is equal to the amount of the credit determined for such taxable year under section 48D(a), reduced by—

(i) the amount disallowed as a deduction by reason of section 48D(e)(2)(B), and

(ii) the amount of any basis reduction under section 48D(e)(1).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—In the case of expenses described in paragraph (1)(A) taken into account in determining the credit under section 48D for the taxable year, if—

(A) the amount of the portion of the credit determined under such section with respect to such expenses, exceeds

(B) the amount allowable as a deduction for such taxable year for such expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) CONTROLLED GROUPS.—Paragraph (3) of subsection (b) shall apply for purposes of this subsection.

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B. CHANGES IN EXISTING LAW PROPOSED BY THE BILL, AS REPORTED

In compliance with clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives, changes in existing law proposed by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter A—Determination of Tax Liability

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PART IV—CREDITS AGAINST TAX

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Subpart D—Business Related Credits

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SEC. 38. GENERAL BUSINESS CREDIT.

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

(1) the business credit carryforwards carried to such taxable year,

(2) the amount of the current year business credit, plus

(3) the business credit carrybacks carried to such taxable year.

(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

(1) the investment credit determined under section 46,

(2) the work opportunity credit determined under section 51(a),

(3) the alcohol fuels credit determined under section 40(a),

(4) the research credit determined under section 41(a),

(5) the low-income housing credit determined under section 42(a),

(6) the enhanced oil recovery credit under section 43(a),

(7) in the case of an eligible small business (as defined in section 44(b)), the disabled access credit determined under section 44(a),

(8) the renewable electricity production credit under section 45(a),

(9) the empowerment zone employment credit determined under section 1396(a),

(10) the Indian employment credit as determined under section 45A(a),

(11) the employer social security credit determined under section 45B(a),

(12) the orphan drug credit determined under section 45C(a),

(13) the new markets tax credit determined under section 45D(a),

(14) in the case of an eligible employer (as defined in section 45E(c)), the small employer pension plan startup cost credit determined under section 45E(a),

(15) the employer-provided child care credit determined under section 45F(a),

(16) the railroad track maintenance credit determined under section 45G(a),

(17) the biodiesel fuels credit determined under section 40A(a),

(18) the low sulfur diesel fuel production credit determined under section 45H(a),

(19) the marginal oil and gas well production credit determined under section 45I(a),

(20) the distilled spirits credit determined under section 5011(a),

(21) the advanced nuclear power facility production credit determined under section 45J(a),

(22) the nonconventional source production credit determined under section 45K(a),

(23) the new energy efficient home credit determined under section 45L(a),

(24) the energy efficient appliance credit determined under section 45M(a),

(25) the portion of the alternative motor vehicle credit to which section 30B(g)(1) applies,

(26) the portion of the alternative fuel vehicle refueling property credit to which section 30C(d)(1) applies,

(27) the Hurricane Katrina housing credit determined under section 1400P(b),

(28) the Hurricane Katrina employee retention credit determined under section 1400R(a),

(29) the Hurricane Rita employee retention credit determined under section 1400R(b),

(30) the Hurricane Wilma employee retention credit determined under section 1400R(c),

(31) the mine rescue team training credit determined under section 45N(a),

(32) in the case of an eligible agricultural business (as defined in section 45O(e)), the agricultural chemicals security credit determined under section 45O(a),

(33) the differential wage payment credit determined under section 45P(a),

(34) the carbon dioxide sequestration credit determined under section 45Q(a)

(35) the portion of the new qualified plug-in electric drive motor vehicle credit to which section 30D(c)(1) applies, plus

(36) the small employer health insurance credit determined under section 45R.

(c) LIMITATION BASED ON AMOUNT OF TAX.—

(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess (if any) of the taxpayer's net income tax over the greater of—

(A) the tentative minimum tax for the taxable year, or

(B) 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000.

For purposes of the preceding sentence, the term "net income tax" means the sum of the regular tax liability and the tax imposed by section 55, reduced by the credits allowable under subparts A and B of this part, and the term "net regular tax liability" means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

(2) EMPOWERMENT ZONE EMPLOYMENT CREDIT MAY OFFSET 25 PERCENT OF MINIMUM TAX.—

(A) IN GENERAL.—In the case of the empowerment zone employment credit—

(i) this section and section 39 shall be applied separately with respect to such credit, and

(ii) for purposes of applying paragraph (1) to such credit—

(I) 75 percent of the tentative minimum tax shall be substituted for the tentative minimum tax under subparagraph (A) thereof, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the empowerment zone employment credit, the New York Liberty Zone business employee credit, the eligible small business credits, and the specified credits).

(B) EMPOWERMENT ZONE EMPLOYMENT CREDIT.—For purposes of this paragraph, the term "empowerment zone employment credit" means the portion of the credit under subsection (a) which is attributable to the credit determined under section 1396 (relating to empowerment zone employment credit).

(3) SPECIAL RULES FOR NEW YORK LIBERTY ZONE BUSINESS EMPLOYEE CREDIT.—

(A) IN GENERAL.—In the case of the New York Liberty Zone business employee credit—

(i) this section and section 39 shall be applied separately with respect to such credit, and

(ii) in applying paragraph (1) to such credit—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the New York Liberty Zone business employee credit, the eligible small business credits, and the specified credits).

(B) NEW YORK LIBERTY ZONE BUSINESS EMPLOYEE CREDIT.—For purposes of this subsection, the term "New York Liberty Zone business employee credit" means the portion of work opportunity credit under section 51 determined under section 1400L(a).

(4) SPECIAL RULES FOR SPECIFIED CREDITS.—

(A) IN GENERAL.—In the case of specified credits—

(i) this section and section 39 shall be applied separately with respect to such credits, and

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the eligible small business credits and the specified credits).

(B) SPECIFIED CREDITS.—For purposes of this subsection, the term "specified credits" means—

(i) for taxable years beginning after December 31, 2004, the credit determined under section 40,

(ii) the credit determined under section 41 for the taxable year with respect to an eligible small business

(as defined in paragraph (5)(C), after application of rules similar to the rules of paragraph (5)(D)),

[(ii)] *(iii)* the credit determined under section 42 to the extent attributable to buildings placed in service after December 31, 2007,

[(iii)] *(iv)* the credit determined under section 45 to the extent that such credit is attributable to electricity or refined coal produced—

(I) at a facility which is originally placed in service after the date of the enactment of this paragraph, and

(II) during the 4-year period beginning on the date that such facility was originally placed in service,

[(iv)] *(v)* the credit determined under section 45B,

[(v)] *(vi)* the credit determined under section 45G,

[(vi)] *(vii)* the credit determined under section 45R,

[(vii)] *(viii)* the credit determined under section 46 to the extent that such credit is attributable to the energy credit determined under section 48,

[(viii)] *(ix)* the credit determined under section 46 to the extent that such credit is attributable to the rehabilitation credit under section 47, but only with respect to qualified rehabilitation expenditures properly taken into account for periods after December 31, 2007, and

[(ix)] *(x)* the credit determined under section 51.

(5) SPECIAL RULES FOR ELIGIBLE SMALL BUSINESS CREDITS IN 2010.—

(A) IN GENERAL.—In the case of eligible small business credits determined in taxable years beginning in 2010—

(i) this section and section 39 shall be applied separately with respect to such credits, and

(ii) in applying paragraph (1) to such credits—

(I) the tentative minimum tax shall be treated as being zero, and

(II) the limitation under paragraph (1) (as modified by subclause (I)) shall be reduced by the credit allowed under subsection (a) for the taxable year (other than the eligible small business credits).

(B) ELIGIBLE SMALL BUSINESS CREDITS.—For purposes of this subsection, the term "eligible small business credits" means the sum of the credits listed in subsection (b) which are determined for the taxable year with respect to an eligible small business. Such credits shall not be taken into account under paragraph (2), (3), or (4).

(C) ELIGIBLE SMALL BUSINESS.—For purposes of this subsection, the term "eligible small business" means, with respect to any taxable year—

(i) a corporation the stock of which is not publicly traded,

(ii) a partnership, or

(iii) a sole proprietorship, if the average annual gross receipts of such corporation, partnership, or sole

proprietorship for the 3-taxable-year period preceding such taxable year does not exceed $50,000,000. For purposes of applying the test under the preceding sentence, rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.

(D) TREATMENT OF PARTNERS AND S CORPORATION SHAREHOLDERS.—Credits determined with respect to a partnership or S corporation shall not be treated as eligible small business credits by any partner or shareholder unless such partner or shareholder meets the gross receipts test under subparagraph (C) for the taxable year in which such credits are treated as current year business credits.

(6) SPECIAL RULES.—

(A) MARRIED INDIVIDUALS.—In the case of a husband or wife who files a separate return, the amount specified under subparagraph (B) of paragraph (1) shall be $12,500 in lieu of $25,000. This subparagraph shall not apply if the spouse of the taxpayer has no business credit carryforward or carryback to, and has no current year business credit for, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

(B) CONTROLLED GROUPS.—In the case of a controlled group, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced for each component member of such group by apportioning $25,000 among the component members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term "controlled group" has the meaning given to such term by section 1563(a).

(C) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(1) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), the $25,000 amount specified under subparagraph (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2) (as so in effect) of such amount.

(D) ESTATES AND TRUSTS.—In the case of an estate or trust, the $25,000 amount specified under subparagraph (B) of paragraph (1) shall be reduced to an amount which bears the same ratio to $25,000 as the portion of the income of the estate or trust which is not allocated to beneficiaries bears to the total income of the estate or trust.

(d) ORDERING RULES.—For purposes of any provision of this title where it is necessary to ascertain the extent to which the credits determined under any section referred to in subsection (b) are used in a taxable year or as a carryback or carryforward—

(1) IN GENERAL.—The order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b) as of the close of the taxable year in which the credit is used.

(2) COMPONENTS OF INVESTMENT CREDIT.—The order in which the credits listed in section 46 are used shall be determined on the basis of the order in which such credits are listed

in section 46 as of the close of the taxable year in which the credit is used.

* * * * * * *

SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

[(a) GENERAL RULE.—For purposes of section 38, the 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,

[(2) 20 percent of the basic research payments determined under subsection (e)(1)(A), and

[(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.]

(a) IN GENERAL.—For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of—

(1) 20 percent 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,

(2) 20 percent of so much of the basic research payments for the taxable year as exceeds 50 percent of the average basic research payments for the 3 taxable years preceding the taxable year for which the credit is being determined, plus

(3) 20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

(b) QUALIFIED RESEARCH EXPENSES.—For purposes of this section—

(1) QUALIFIED RESEARCH EXPENSES.—The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer—

(A) in-house research expenses, and

(B) contract research expenses.

(2) IN-HOUSE RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "in-house research expenses" means—

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) re-

ceives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) QUALIFIED SERVICES.—The term "qualified services" means services consisting of—

(i) engaging in qualified research, or

(ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause (i) or (ii), the term "qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) SUPPLIES.—The term "supplies" means any tangible property other than—

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) WAGES.—

(i) IN GENERAL.—The term "wages" has the meaning given such term by section 3401(a).

(ii) SELF-EMPLOYED INDIVIDUALS AND OWNER-EMPLOYEES.—In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) EXCLUSION FOR WAGES TO WHICH WORK OPPORTUNITY CREDIT APPLIES.—The term "wages" shall not include any amount taken into account in determining the work opportunity credit under section 51(a).

(3) CONTRACT RESEARCH EXPENSES.—

(A) IN GENERAL.—The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) PREPAID AMOUNTS.—If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(C) AMOUNTS PAID TO CERTAIN RESEARCH CONSORTIA.—

(i) IN GENERAL.—Subparagraph (A) shall be applied by substituting "75 percent" for "65 percent" with respect to amounts paid or incurred by the taxpayer to a qualified research consortium for qualified research on behalf of the taxpayer and 1 or more unrelated taxpayers. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related taxpayers.

(ii) QUALIFIED RESEARCH CONSORTIUM.—The term "qualified research consortium" means any organization which—

(I) is described in section 501(c)(3) or 501(c)(6) and is exempt from tax under section 501(a),

(II) is organized and operated primarily to conduct scientific research, and

(III) is not a private foundation.

(D) AMOUNTS PAID TO ELIGIBLE SMALL BUSINESSES, UNIVERSITIES, AND FEDERAL LABORATORIES.—

(i) IN GENERAL.—In the case of amounts paid by the taxpayer to—

(I) an eligible small business,

(II) an institution of higher education (as defined in section 3304(f)), or

(III) an organization which is a Federal laboratory,

for qualified research which is energy research, subparagraph (A) shall be applied by substituting "100 percent" for "65 percent".

(ii) ELIGIBLE SMALL BUSINESS.—For purposes of this subparagraph, the term "eligible small business" means a small business with respect to which the taxpayer does not own (within the meaning of section 318) 50 percent or more of—

(I) in the case of a corporation, the outstanding stock of the corporation (either by vote or value), and

(II) in the case of a small business which is not a corporation, the capital and profits interests of the small business.

(iii) SMALL BUSINESS.—For purposes of this subparagraph—

(I) IN GENERAL.—The term "small business" means, with respect to any calendar year, any person if the annual average number of employees employed by such person during either of the 2 preceding calendar years was 500 or fewer. For purposes of the preceding sentence, a preceding calendar year may be taken into account only if the person was in existence throughout the year.

(II) STARTUPS, CONTROLLED GROUPS, AND PREDECESSORS.—Rules similar to the rules of subparagraphs (B) and (D) of section 220(c)(4) shall apply for purposes of this clause.

(iv) FEDERAL LABORATORY.—For purposes of this subparagraph, the term "Federal laboratory" has the meaning given such term by section 4(6) of the Stevenson-Wydler Technology Innovation Act of 1980 (15 U.S.C. 3703(6)), as in effect on the date of the enactment of the Energy Tax Incentives Act of 2005.

(4) TRADE OR BUSINESS REQUIREMENT DISREGARDED FOR IN-HOUSE RESEARCH EXPENSES OF CERTAIN STARTUP VENTURES.—In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in mak-

ing such expenditures is to use the results of the research in the active conduct of a future trade or business—

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

[(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 (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.

[(B) START-UP COMPANIES.—

[(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The fixed-base percentage shall be determined under this subparagraph if—

[(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

[(II) there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

[(ii) FIXED-BASE PERCENTAGE.—In a case to which this subparagraph applies, the fixed-base percentage is—

[(I) 3 percent for each of the taxpayer's 1st 5 taxable years beginning after December 31, 1993, for which the taxpayer has qualified research expenses,

[(II) in the case of the taxpayer's 6th such taxable year, 1/6 of the percentage which the aggregate qualified research expenses of the taxpayer for the 4th and 5th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

[(III) in the case of the taxpayer's 7th such taxable year, 1/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th and 6th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

[(IV) in the case of the taxpayer's 8th such taxable year, 1/2 of the percentage which the aggre-

gate qualified research expenses of the taxpayer for the 5th, 6th, and 7th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

[(V) in the case of the taxpayer's 9th such taxable year, 2/3 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, and 8th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

[(VI) in the case of the taxpayer's 10th such taxable year, 5/6 of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, 8th, and 9th such taxable years is of the aggregate gross receipts of the taxpayer for such years, and

[(VII) for taxable years thereafter, the percentage which the aggregate qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through the 10th such taxable years is of the aggregate gross receipts of the taxpayer for such selected years.

[(iii) TREATMENT OF DE MINIMIS AMOUNTS OF GROSS RECEIPTS AND QUALIFIED RESEARCH EXPENSES.—The Secretary may prescribe regulations providing that de minimis amounts of gross receipts and qualified research expenses shall be disregarded under clauses (i) and (ii).

[(C) MAXIMUM FIXED-BASE PERCENTAGE.—In no event shall the fixed-base percentage exceed 16 percent.

[(D) ROUNDING.—The percentages determined under subparagraphs (A) and (B)(ii) shall be rounded to the nearest 1/100th of 1 percent.

[(4) ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

[(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to the sum of—

[(i) 3 percent of so much of the qualified research expenses for the taxable year as exceeds 1 percent of the average described in subsection (c)(1)(B) but does not exceed 1.5 percent of such average,

[(ii) 4 percent of so much of such expenses as exceeds 1.5 percent of such average but does not exceed 2 percent of such average, and

[(iii) 5 percent of so much of such expenses as exceeds 2 percent of such average.

[(B) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

[(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 re-

search 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.

[(B) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAXABLE YEARS.—

[(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

[(ii) CREDIT RATE.—The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

[(C) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. An election under this paragraph may not be made for any taxable year to which an election under paragraph (4) applies.

[(6) CONSISTENT TREATMENT OF EXPENSES REQUIRED.—

[(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

[(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

[(7) GROSS RECEIPTS.—For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.]

(c) DETERMINATION OF AVERAGE RESEARCH EXPENSES FOR PRIOR YEARS.—

(1) SPECIAL RULE IN CASE OF NO QUALIFIED RESEARCH EXPENDITURES IN ANY OF 3 PRECEDING TAXABLE YEARS.—In any case in which the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined, the amount determined under subsection (a)(1) for such taxable year shall be equal to 10 percent of the qualified research expenses for the taxable year.

(2) CONSISTENT TREATMENT OF EXPENSES.—

(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the average qualified research expenses, or average basic research payments, taken into account under subsection (a), the qualified research expenses and basic research payments taken into account in determining such averages shall be determined on a basis consistent with the determination of qualified research expenses and basic research payments, respectively, for the credit year.

(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or basic research payments caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in determining the average qualified research expenses or average basic research payments taken into account under subsection (a).

(d) QUALIFIED RESEARCH DEFINED.—For purposes of this section—

(1) IN GENERAL.—The term "qualified research" means research—

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) TESTS TO BE APPLIED SEPARATELY TO EACH BUSINESS COMPONENT.—For purposes of this subsection—

(A) IN GENERAL.—Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B) BUSINESS COMPONENT DEFINED.—The term "business component" means any product, process, computer software, technique, formula, or invention which is to be—

(i) held for sale, lease, or license, or

(ii) used by the taxpayer in a trade or business of the taxpayer.

(C) SPECIAL RULE FOR PRODUCTION PROCESSES.—Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

(3) PURPOSES FOR WHICH RESEARCH MAY QUALIFY FOR CREDIT.—For purposes of paragraph (1)(C)—

(A) IN GENERAL.—Research shall be treated as conducted for a purpose described in this paragraph if it relates to—

(i) a new or improved function,
(ii) performance, or
(iii) reliability or quality.

(B) CERTAIN PURPOSES NOT QUALIFIED.—Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) ACTIVITIES FOR WHICH CREDIT NOT ALLOWED.—The term "qualified research" shall not include any of the following:

(A) RESEARCH AFTER COMMERCIAL PRODUCTION.—Any research conducted after the beginning of commercial production of the business component.

(B) ADAPTATION OF EXISTING BUSINESS COMPONENTS.—Any research related to the adaptation of an existing business component to a particular customer's requirement or need.

(C) DUPLICATION OF EXISTING BUSINESS COMPONENT.—Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) SURVEYS, STUDIES, ETC..—Any—

(i) efficiency survey,
(ii) activity relating to management function or technique,
(iii) market research, testing, or development (including advertising or promotions),
(iv) routine data collection, or
(v) routine or ordinary testing or inspection for quality control.

(E) COMPUTER SOFTWARE.—Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in—

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or
(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) FOREIGN RESEARCH.—Any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(G) SOCIAL SCIENCES, ETC..—Any research in the social sciences, arts, or humanities.

(H) FUNDED RESEARCH.—Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

[(e) CREDIT ALLOWABLE WITH RESPECT TO CERTAIN PAYMENTS TO QUALIFIED ORGANIZATIONS FOR BASIC RESEARCH.—For purposes of this section—

[(1) IN GENERAL.—In the case of any taxpayer who makes basic research payments for any taxable year—

[(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

[(i) such basic research payments, over

[(ii) the qualified organization base period amount, and

[(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

[(2) BASIC RESEARCH PAYMENTS DEFINED.—For purposes of this subsection—

[(A) IN GENERAL.—The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

[(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

[(ii) such basic research is to be performed by such qualified organization.

[(B) EXCEPTION TO REQUIREMENT THAT RESEARCH BE PERFORMED BY THE ORGANIZATION.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

[(3) QUALIFIED ORGANIZATION BASE PERIOD AMOUNT.—For purposes of this subsection, the term "qualified organization base period amount" means an amount equal to the sum of—

[(A) the minimum basic research amount, plus

[(B) the maintenance-of-effort amount.

[(4) MINIMUM BASIC RESEARCH AMOUNT.—For purposes of this subsection—

[(A) IN GENERAL.—The term "minimum basic research amount" means an amount equal to the greater of—

[(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for—

[(I) any in-house research expenses, and

[(II) any contract research expenses, or

[(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

[(B) FLOOR AMOUNT.—Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

[(5) MAINTENANCE-OF-EFFORT AMOUNT.—For purposes of this subsection—

[(A) IN GENERAL.—The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of—

[(i) an amount equal to—

[(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

[(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over (ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

[(B) NONDESIGNATED UNIVERSITY CONTRIBUTIONS.—For purposes of this paragraph, the term "nondesignated university contribution" means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A)—

[(i) for which a deduction was allowable under section 170, and

[(ii) which was not taken into account—

[(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

[(II) as a basic research payment for purposes of this section.

[(C) COST-OF-LIVING ADJUSTMENT DEFINED.—

[(i) IN GENERAL.—The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3), by substituting "calendar year 1987" for "calendar year 1992" in subparagraph (B) thereof.

[(ii) SPECIAL RULE WHERE BASE PERIOD ENDS IN A CALENDAR YEAR OTHER THAN 1983 OR 1984.—If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(B) shall, or purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 1992. Such substitution shall be in lieu of the substitution under clause (i).]

(e) BASIC RESEARCH PAYMENTS.— For purposes of this section—

(1) IN GENERAL.—The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

(A) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(B) such basic research is to be performed by such qualified organization.

(2) EXCEPTION TO REQUIREMENT THAT RESEARCH BE PERFORMED BY THE ORGANIZATION.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (3), subparagraph (B) of paragraph (1) shall not apply.

[(6)] *(3)* QUALIFIED ORGANIZATION.—For purposes of this subsection, the term "qualified organization" means any of the following organizations:

(A) EDUCATIONAL INSTITUTIONS.—Any educational organization which—

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii).

(B) CERTAIN SCIENTIFIC RESEARCH ORGANIZATIONS.—Any organization not described in subparagraph (A) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a),

(ii) is organized and operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) SCIENTIFIC TAX-EXEMPT ORGANIZATIONS.—Any organization which—

(i) is described in—

(I) section 501(c)(3) (other than a private foundation), or

(II) section 501(c)(6),

(ii) is exempt from tax under section 501(a),

(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends—

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A).

(D) CERTAIN GRANT ORGANIZATIONS.—Any organization not described in subparagraph (B) or (C) which—

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

[(7)**]** *(4)* DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) BASIC RESEARCH.—The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include—

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts, or humanities.

[(B) BASE PERIOD.—The term "base period" means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

[(C) EXCLUSION FROM INCREMENTAL CREDIT CALCULATION.—For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)—

[(i) shall not be treated as qualified research expenses under subsection (a)(1)(A), and

[(ii) shall not be included in the computation of base amount under subsection (a)(1)(B).]

[(D)] *(B)* TRADE OR BUSINESS QUALIFICATION.—For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

[(E)] *(C)* CERTAIN CORPORATIONS NOT ELIGIBLE.—The term "corporation" shall not include—

(i) an S corporation,

(ii) a personal holding company (as defined in section 542), or

(iii) a service organization (as defined in section 414(m)(3)).

(f) SPECIAL RULES.—For purposes of this section—

(1) AGGREGATION OF EXPENDITURES.—

(A) CONTROLLED GROUP OF CORPORATIONS.—In determining the amount of the credit under this section—

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.

(B) COMMON CONTROL.—Under regulations prescribed by the Secretary, in determining the amount of the credit under this section—

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by all such persons under common control for purposes of this section.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A).

(2) ALLOCATIONS.—

(A) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) ALLOCATION IN THE CASE OF PARTNERSHIPS.—In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) ADJUSTMENTS FOR CERTAIN ACQUISITIONS, ETC..—Under regulations prescribed by the Secretary—

(A) ACQUISITIONS.—

(i) IN GENERAL.—If a person acquires the major portion of either a trade or business or a separate unit of a trade or business (hereinafter in this paragraph referred to as the "acquired business") of another person (hereinafter in this paragraph referred to as the "predecessor"), then the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period shall be increased by the amount determined under clause (ii)**[**, and the gross receipts of the acquiring person for such period shall be increased by the amount determined under clause (iii)**]**.

(ii) AMOUNT DETERMINED WITH RESPECT TO QUALIFIED RESEARCH EXPENSES.—The amount determined under this clause is—

(I) for purposes of applying this section for the taxable year in which such acquisition is made, the acquisition year amount, and

(II) for purposes of applying this section for any taxable year after the taxable year in which such acquisition is made, the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period.

[(iii) AMOUNT DETERMINED WITH RESPECT TO GROSS RECEIPTS.—The amount determined under this clause is the amount which would be determined under clause (ii) if "the gross receipts of" were substituted for "the qualified research expenses paid or incurred by" each place it appears in clauses (ii) and (iv).**]**

[(iv)**]** *(iii)* ACQUISITION YEAR AMOUNT.—For purposes of clause (ii), the acquisition year amount is the amount equal to the product of—

(I) the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period, and

(II) the number of days in the period beginning on the date of the acquisition and ending on the last day of the taxable year in which the acquisition is made,

divided by the number of days in the acquiring person's taxable year.

[(v)**]** *(iv)* SPECIAL RULES FOR COORDINATING TAXABLE YEARS.—In the case of an acquiring person and a pred-

ecessor whose taxable years do not begin on the same date—

(I) each reference to a taxable year in clauses (ii) [and (iv)] *and (iii)* shall refer to the appropriate taxable year of the acquiring person,

(II) the qualified research expenses paid or incurred by the predecessor[, and the gross receipts of the predecessor,] during each taxable year of the predecessor any portion of which is part of the measurement period shall be allocated equally among the days of such taxable year, *and*

(III) the amount of such qualified research expenses taken into account under clauses (ii) [and (iv)] *and (iii)* with respect to a taxable year of the acquiring person shall be equal to the total of the expenses attributable under subclause (II) to the days occurring during such taxable year[, and].

[(IV) the amount of such gross receipts taken into account under clause (iii) with respect to a taxable year of the acquiring person shall be equal to the total of the gross receipts attributable under subclause (II) to the days occurring during such taxable year.]

[(vi)] *(v)* MEASUREMENT PERIOD.—For purposes of this subparagraph, the term "measurement period" means, with respect to the taxable year of the acquiring person for which the credit is determined, any period of the acquiring person preceding such taxable year which is taken into account for purposes of determining the credit for such year.

(B) DISPOSITIONS.—If the predecessor furnished to the acquiring person such information as is necessary for the application of subparagraph (A), then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by[, and the gross receipts of,] the predecessor during the measurement period (as defined in subparagraph [(A)(vi)] *(A)(v)*, determined by substituting "predecessor" for "acquiring person" each place it appears) shall be reduced by—

(i) in the case of the taxable year in which such disposition is made, an amount equal to the product of—

(I) the qualified research expenses paid or incurred by[, or gross receipts of,] the predecessor with respect to the acquired business during the measurement period (as so defined and so determined), and

(II) the number of days in the period beginning on the date of acquisition (as determined for purposes of subparagraph [(A)(iv)(II)] *(A)(iii)(II)*) and ending on the last day of the taxable year of the predecessor in which the disposition is made,

divided by the number of days in the taxable year of the predecessor, and

(ii) in the case of any taxable year ending after the taxable year in which such disposition is made, the amount described in clause (i)(I).

[(C) CERTAIN REIMBURSEMENTS TAKEN INTO ACCOUNT IN DETERMINING FIXED-BASE PERCENTAGE.—If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of—

[(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

[(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph.]

(C) ADJUSTMENTS FOR BASIC RESEARCH PAYMENTS.—In the case of basic research payments, rules similar to the rules of subparagraph (A) and (B) shall apply.

(4) SHORT TAXABLE YEARS.—In the case of any short taxable year, qualified research expenses [and gross receipts] *and basic research payments* shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) CONTROLLED GROUP OF CORPORATIONS.—The term "controlled group of corporations" has the same meaning given to such term by section 1563(a), except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

(6) ENERGY RESEARCH CONSORTIUM.—

(A) IN GENERAL.—The term "energy research consortium" means any organization—

(i) which is—

(I) described in section 501(c)(3) and is exempt from tax under section 501(a) and is organized and operated primarily to conduct energy research, or

(II) organized and operated primarily to conduct energy research in the public interest (within the meaning of section 501(c)(3)),

(ii) which is not a private foundation,

(iii) to which at least 5 unrelated persons paid or incurred during the calendar year in which the taxable year of the organization begins amounts (including as contributions) to such organization for energy research, and

(iv) to which no single person paid or incurred (including as contributions) during such calendar year an amount equal to more than 50 percent of the total amounts received by such organization during such calendar year for energy research.

(B) TREATMENT OF PERSONS.—All persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related persons for purposes of subparagraph (A)(iii) and as a single person for purposes of subparagraph (A)(iv).

(C) FOREIGN RESEARCH.—For purposes of subsection (a)(3), amounts paid or incurred for any energy research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States shall not be taken into account.

(D) DENIAL OF DOUBLE BENEFIT.—Any amount taken into account under subsection (a)(3) shall not be taken into account under paragraph (1) or (2) of subsection (a).

(E) ENERGY RESEARCH.—The term "energy research" does not include any research which is not qualified research.

(g) SPECIAL RULE FOR PASS-THRU OF CREDIT.—In the case of an individual who—

(1) owns an interest in an unincorporated trade or business,

(2) is a partner in a partnership,

(3) is a beneficiary of an estate or trust, or

(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39.

[(h) TERMINATION.—

[(1) IN GENERAL.—This section shall not apply to any amount paid or incurred after December 31, 2014.

[(2) TERMINATION OF ALTERNATIVE INCREMENTAL CREDIT.—No election under subsection (c)(4) shall apply to taxable years beginning after December 31, 2008.

[(2) COMPUTATION FOR TAXABLE YEAR IN WHICH CREDIT TERMINATES.—In the case of any taxable year with respect to which this section applies to a number of days which is less than the total number of days in such taxable year—

[(A) the amount determined under subsection (c)(1)(B) with respect to such taxable year shall be the amount which bears the same ratio to such amount (determined without regard to this paragraph) as the number of days in such taxable year to which this section applies bears to the total number of days in such taxable year, and

[(B) for purposes of subsection (c)(5), the average qualified research expenses for the preceding 3 taxable years shall be the amount which bears the same ratio to such average qualified research expenses (determined without regard to this paragraph) as the number of days in such taxable year to which this section applies bears to the total number of days in such taxable year.]

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SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) GENERAL RULE.—For purposes of section 38, the credit determined under this section for the taxable year is an amount equal to 50 percent of the qualified clinical testing expenses for the taxable year.

(b) QUALIFIED CLINICAL TESTING EXPENSES.—For purposes of this section—

(1) QUALIFIED CLINICAL TESTING EXPENSES.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term "qualified clinical testing expenses" means the amounts which are paid or incurred by the taxpayer during the taxable year which would be described in subsection (b) of section 41 if such subsection were applied with the modifications set forth in subparagraph (B).

(B) MODIFICATIONS.—For purposes of subparagraph (A), subsection (b) of section 41 shall be applied—

(i) by substituting "clinical testing" for "qualified research" each place it appears in paragraphs (2) and (3) of such subsection, and

(ii) by substituting "100 percent" for "65 percent" in paragraph (3)(A) of such subsection.

(C) EXCLUSION FOR AMOUNTS FUNDED BY GRANTS, ETC.—The term "qualified clinical testing expenses" shall not include any amount to the extent such amount is funded by any grant, contract, or otherwise by another person (or any governmental entity).

[(D) SPECIAL RULE.—If section 41 is not in effect for any period, such section shall be deemed to remain in effect for such period for purposes of this paragraph.]

(2) CLINICAL TESTING.—

(A) IN GENERAL.—The term "clinical testing" means any human clinical testing—

(i) which is carried out under an exemption for a drug being tested for a rare disease or condition under section 505(i) of the Federal Food, Drug, and Cosmetic Act (or regulations issued under such section),

(ii) which occurs—

(I) after the date such drug is designated under section 526 of such Act, and

(II) before the date on which an application with respect to such drug is approved under section 505(b) of such Act or, if the drug is a biological product, before the date on which a license for such drug is issued under section 351 of the Public Health Service Act; and

(iii) which is conducted by or on behalf of the taxpayer to whom the designation under such section 526 applies.

(B) TESTING MUST BE RELATED TO USE FOR RARE DISEASE OR CONDITION.—Human clinical testing shall be taken into account under subparagraph (A) only to the extent such testing is related to the use of a drug for the rare disease or condition for which it was designated under section 526 of the Federal Food, Drug, and Cosmetic Act.

(c) COORDINATION WITH CREDIT FOR INCREASING RESEARCH EXPENDITURES.—

(1) IN GENERAL.—Except as provided in paragraph (2), any qualified clinical testing expenses for a taxable year to which an election under this section applies shall not be taken into account for purposes of determining the credit allowable under section 41 for such taxable year.

(2) EXPENSES INCLUDED IN DETERMINING [BASE PERIOD RESEARCH EXPENSES] *AVERAGE QUALIFIED RESEARCH EXPENSES*.—Any qualified clinical testing expenses for any taxable year which are qualified research expenses (within the meaning of section 41(b)) shall be taken into account in determining [base period research expenses] *average qualified research expenses* for purposes of applying section 41 to subsequent taxable years.

(d) DEFINITION AND SPECIAL RULES.—

(1) RARE DISEASE OR CONDITION.—For purposes of this section, the term "rare disease or condition" means any disease or condition which—

(A) affects less than 200,000 persons in the United States, or

(B) affects more than 200,000 persons in the United States but for which there is no reasonable expectation that the cost of developing and making available in the United States a drug for such disease or condition will be recovered from sales in the United States of such drug.

Determinations under the preceding sentence with respect to any drug shall be made on the basis of the facts and circumstances as of the date such drug is designated under section 526 of the Federal Food, Drug, and Cosmetic Act.

(2) SPECIAL LIMITATIONS ON FOREIGN TESTING.—

(A) IN GENERAL.—No credit shall be allowed under this section with respect to any clinical testing conducted outside the United States unless—

(i) such testing is conducted outside the United States because there is an insufficient testing population in the United States, and

(ii) such testing is conducted by a United States person or by any other person who is not related to the taxpayer to whom the designation under section 526 of the Federal Food, Drug, and Cosmetic Act applies.

(B) SPECIAL LIMITATION FOR CORPORATIONS TO WHICH SECTION 936 APPLIES.—No credit shall be allowed under this section with respect to any clinical testing conducted by a corporation to which an election under section 936 applies.

(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (1) and (2) of section 41(f) shall apply for purposes of this section.

(4) ELECTION.—This section shall apply to any taxpayer for any taxable year only if such taxpayer elects (at such time and in such manner as the Secretary may by regulations prescribe) to have this section apply for such taxable year.

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Subchapter B—Computation of Taxable Income

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PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 280C. CERTAIN EXPENSES FOR WHICH CREDITS ARE ALLOWABLE.

(a) RULE FOR EMPLOYMENT CREDITS.—No deduction shall be allowed for that portion of the wages or salaries paid or incurred for the taxable year which is equal to the sum of the credits determined for the taxable year under sections 45A(a), 45P(a), 51(a), and 1396(a), 1400P(b), and 1400R. In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 52(a)) or a trade or business which is treated as being under common control with other trades or businesses (within the meaning of section 52(b)), this subsection shall be applied under rules prescribed by the Secretary similar to the rules applicable under subsections (a) and (b) of section 52.

(b) CREDIT FOR QUALIFIED CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified clinical testing expenses (as defined in section 45C(b)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—If—

(A) the amount of the credit allowable for the taxable year under section 45C (determined without regard to section 38(c)), exceeds

(B) the amount allowable as a deduction for the taxable year for qualified clinical testing expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) CONTROLLED GROUPS.—In the case of a corporation which is a member of a controlled group of corporations (within the meaning of section 41(f)(5)) or a trade or business which is treated as being under common control with other trades or business (within the meaning of section 41(f)(1)(B)), this subsection shall be applied under rules prescribed by the Sec-

retary similar to the rules applicable under subparagraphs (A) and (B) of section 41(f)(1).

(c) CREDIT FOR INCREASING RESEARCH ACTIVITIES.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified research expenses (as defined in section 41(b)) or [basic research expenses (as defined in section 41(e)(2))] *basic research payments (as defined in section 41(e)(1))* otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for such taxable year under section 41(a).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—If—

(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

(B) the amount allowable as a deduction for such taxable year for qualified research expenses or [basic research expenses] *basic research payments* (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) ELECTION OF REDUCED CREDIT.—

(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

(i) paragraphs (1) and (2) shall not apply, and

(ii) the amount of the credit under section 41(a) shall be the amount determined under subparagraph (B).

(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

(i) the amount of credit determined under section 41(a) without regard to this paragraph, over

(ii) the product of—

(I) the amount described in clause (i), and

(II) the maximum rate of tax under section 11(b)(1).

(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary may prescribe. Such an election, once made, shall be irrevocable.

(4) CONTROLLED GROUPS.—Paragraph (3) of subsection (b) shall apply for purposes of this subsection.

(d) CREDIT FOR LOW SULFUR DIESEL FUEL PRODUCTION.—The deductions otherwise allowed under this chapter for the taxable year shall be reduced by the amount of the credit determined for the taxable year under section 45H(a).

(e) MINE RESCUE TEAM TRAINING CREDIT.—No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for the taxable year under section 45N(a).

(f) CREDIT FOR SECURITY OF AGRICULTURAL CHEMICALS.—No deduction shall be allowed for that portion of the expenses otherwise

allowable as a deduction taken into account in determining the credit under section 45O for the taxable year which is equal to the amount of the credit determined for such taxable year under section 45O(a).

(g) CREDIT FOR HEALTH INSURANCE PREMIUMS.—

No deduction shall be allowed for the portion of the premiums paid by the taxpayer for coverage of 1 or more individuals under a qualified health plan which is equal to the amount of the credit determined for the taxable year under section 36B(a) with respect to such premiums.

(h) CREDIT FOR EMPLOYEE HEALTH INSURANCE EXPENSES OF SMALL EMPLOYERS.—No deduction shall be allowed for that portion of the premiums for qualified health plans (as defined in section 1301(a) of the Patient Protection and Affordable Care Act), or for health insurance coverage in the case of taxable years beginning in 2010, 2011, 2012, or 2013, paid by an employer which is equal to the amount of the credit determined under section 45R(a) with respect to the premiums.

(g) QUALIFYING THERAPEUTIC DISCOVERY PROJECT CREDIT.—

(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified investment (as defined in section 48D(b)) otherwise allowable as a deduction for the taxable year which—

(A) would be qualified research expenses (as defined in section 41(b)), basic research expenses (as defined in section 41(e)(2)), or qualified clinical testing expenses (as defined in section 45C(b)) if the credit under section 41 or section 45C were allowed with respect to such expenses for such taxable year, and

(B) is equal to the amount of the credit determined for such taxable year under section 48D(a), reduced by—

(i) the amount disallowed as a deduction by reason of section 48D(e)(2)(B), and

(ii) the amount of any basis reduction under section 48D(e)(1).

(2) SIMILAR RULE WHERE TAXPAYER CAPITALIZES RATHER THAN DEDUCTS EXPENSES.—In the case of expenses described in paragraph (1)(A) taken into account in determining the credit under section 48D for the taxable year, if—

(A) the amount of the portion of the credit determined under such section with respect to such expenses, exceeds

(B) the amount allowable as a deduction for such taxable year for such expenses (determined without regard to paragraph (1)),

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.

(3) CONTROLLED GROUPS.—Paragraph (3) of subsection (b) shall apply for purposes of this subsection.

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VII. DISSENTING VIEWS

The two permanent tax extender bills approved by the Republicans at the markup would add more than $224 billion to the deficit. Together with the seven bills that were approved by the Republicans in the previous markup, these nine bills would add more than $317 billion to the deficit. In the 113th Congress, Ways and Means Committee Republicans selectively approved 14 of the more than 50 expired tax provisions, totaling more than $825 billion worth of deficit-financed, permanent tax cuts. This selective approach failed last Congress, with none of these permanent provisions being enacted into law. The bills marked up by the Committee set us down a partisan path, when we should be embracing bipartisanship and working in a responsible, bipartisan manner on tax reform.

Even though some of these bills were introduced individually with some bipartisan support, the opposition to these bills is based on the position that these tax provisions should not be made permanent by adding to the deficit without any revenue offset. The research and experimentation credit is critical to helping our nation's companies innovate and compete. But the fiscally irresponsible approach that the Committee Republicans are taking with respect to this and other important legislation undermines the bipartisan support that the provisions enjoy. It is true that this provision was included in the Republican tax reform plan introduced by the Ways and Means Committee Chairman last Congress—but the cost of this provision was responsibly offset in the ten-year window. Clearly, Chairman Camp recognized the importance of paying for the permanence of these provisions in the Republican tax reform plan, and not playing games by passing these important provisions outside of the important work this Committee has ahead of it. The American people expect a tax code that maintains and supports our shared priorities, and each time the Committee considers these bills in a piecemeal approach, it is taking a step in the wrong direction and away from comprehensive tax reform.

We all support provisions that facilitate innovation and advancement to modernize our economy and enable our companies to grow and continue to lead. The markup was not to debate the need for government involvement in spurring research and development, or the merits of H.R. 880, which would make permanent the expanded tax credit for research and experimentation, and expand the credit to ensure that it would not lose its value for certain taxpayers because of interactions with the alternative minimum tax system.

Finally, we also oppose the manner in which Republicans are proceeding—selecting to make permanent another two provisions today in addition to the previously passed seven provisions at a cost of more than $317 billion without any offset from the more than 50 tax provisions that expired at the end of last year. This

approach is both fiscally irresponsible and contrary to the goals of bipartisan, comprehensive tax reform.

Expired provisions must be dealt with in a comprehensive manner. The Republicans did not take up other tax extenders that also are important to Democratic Committee Members. Left to an uncertain fate are provisions like the Work Opportunity Tax Credit, the New Markets Tax Credit, and the renewable energy tax credits, as well as the long-term status of the Earned Income Tax Credit, the Child Tax Credit, and the American Opportunity Tax Credit.

SANDER M. LEVIN,
Ranking Member.

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