

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

(T.D. 8282)

RIN-1545-A023

**Election of Reduced Research Credit,
Income Taxes**AGENCY: Internal Revenue Service,
Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final income tax regulations relating to the manner of making an election under section 280C(c)(3) of the Internal Revenue Code, as amended by section 7814(e)(2)(A) of the Revenue Reconciliation Act of 1989. This election enables a taxpayer to claim a reduced income tax credit for increasing research activities and thereby avoid a reduction of the section 174 deduction for research and experimental expenditures. These regulations provide guidance to persons making the election.

EFFECTIVE DATE: These regulations are effective for taxable years beginning after December 31, 1989.

FOR FURTHER INFORMATION CONTACT: David S. Hudson, 202-566-4221 (not a toll-free call).

SUPPLEMENTARY INFORMATION:**Paperwork Reduction Act**

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in this regulation has been reviewed and, pending receipt of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1155.

Comments concerning the collection of information and the accuracy of the estimated average annual burden and suggestions for reducing this burden should be directed to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports

Clearance Officer TFP, Washington, DC 20224.

The collection of information in this regulation is in § 1.280C-4. This information is required by the Internal Revenue Service to compute the federal income tax liability of taxpayers. The likely respondents/recordkeepers are business and other for-profit taxpayers.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

The estimated total annual reporting and/or recordkeeping burden is 85 hours.

The estimated average annual burden per respondent/recordkeeper is .3 hours to complete the election.

The estimated number of respondents/recordkeepers making the election described in this regulation is 220.

The estimated annual frequency of responses (for reporting requirements only) is one.

Background

In the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act), Congress extended the termination date of section 41 of the Code, relating to the income tax credit for increasing research activities. At the same time, Congress added a new paragraph (c) to section 280C, effective for taxable years beginning after December 31, 1988. Paragraphs (1) and (2) of new section 280C(c) require taxpayers to reduce the amount of qualified research expenses otherwise allowable as a deduction under section 174 by an amount equal to a certain percentage of the credit determined under section 41(a). For taxable years beginning in 1989, this "deduction disallowance" equals 50 percent of the credit determined under section 41(a). For taxable years beginning after December 31, 1988, section 7110(c) of the Revenue Reconciliation Act of 1989 (the 1989 Act) increases the deduction disallowance to 100 percent of the credit determined under section 41(a).

The 1988 Act also added a new section 41(h) to the Code, which permitted a taxpayer to avoid the section 174 deduction disallowance for a taxable year by electing to forego entirely the taxpayer's section 41(a) credit for the year. Section 7814(e) of the 1989 Act modified this election by

retroactively repealing section 41(h), and adding new section 280C(c)(3). New section 280C(c)(3) reduces an electing taxpayer's section 41(a) credit only by an amount equal to the taxes saved from avoiding the deduction disallowance.

Specifically, under new section 280C(c)(3)(C), a taxpayer is permitted to avoid the deduction disallowance provisions of section 280C(c)(1) and (2) by electing to reduce its section 41(a) credit by the amount of tax saved (assuming the highest corporate tax rate) by not making a reduction in the amount allowable as a deduction under section 174. (See section 280C(c)(3) as amended by sections 7814(e) and 7110(c)(1) of the 1989 Act.) Subparagraph (B) of section 280C(c)(3) provides the method for computing the reduced credit for taxpayers making this election. The taxpayer must first compute its section 41(a) credit without regard to section 280C(c)(3), and then multiply this amount (or 50 percent of this amount for taxable years beginning before January 1, 1990) by the maximum rate of tax in section 11(b)(1) of the Code. The product of this multiplication is then subtracted from the full amount of the section 41(a) credit. The remainder is the amount of credit allowed.

Section 280C(c)(3)(C) provides that the election shall be made not later than the time for filing the federal tax return (including extensions) for the taxable year in which the election is made. The election shall be made on such return, and shall be made in such manner as the Secretary of the Treasury may prescribe. The election for a taxable year, once made, shall be irrevocable. In the case of a taxable year for which the time for filing the return of tax (including extensions) is on or before the date which is 75 days after the enactment of the 1989 Act (that date is March 4, 1990), section 7814(e)(2)(B) of the 1989 Act provides that the election for that taxable year may be made at any time before the date which is 75 days after the date of enactment of the 1989 Act, in the manner prescribed by the Secretary of the Treasury. This document contains regulations prescribing the manner for making the election.

Explanation of Provisions

Regulations § 1.280C-4 provides that the election under section 280C(c)(3) shall be made by claiming the reduced research credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original return, filed at any time on or before the due date (including extensions) for filing the income tax return for such year.

Except as provided below, for a taxable year described in section 7814(e)(2)(B) of the 1989 Act (that is, a taxable year beginning after December 31, 1988 for which the time for filing the return (including extensions) is on or before March 4, 1990), the election shall be made by claiming the reduced credit on an original or amended return filed on or before March 3, 1990.

A taxpayer will be treated as having made the election under section 280C(c)(3) if (1) prior to December 19, 1989 (the enactment date of the 1989 Act) the taxpayer made an election for a taxable year described in section 7814(e)(2)(B) of the 1989 Act under former section 41(h) (by not claiming any section 41(a) credit), and (2) the taxpayer has not filed an amended return on or before March 3, 1990 claiming the full credit allowable under section 41(a). In effect, taxpayers that elected under former section 41(h) to forego all of the credit in favor of a full deduction will be treated as having elected to forego a part of the credit under section 280C(c)(3). If a taxpayer who made the section 41(h) election does not wish to be treated as having made an election under section 280C(c)(3), the taxpayer must file an amended return for such taxable year on or before March 3, 1990, claiming the full section 41(a) credit. If a taxpayer is treated as having made the section 280C(c)(3) election in the taxable year described above, the provisions of section 280C(c)(1) and (2) shall not apply in such taxable year.

In order to obtain the benefit of the reduced section 41(a) credit, a taxpayer who is treated as having made the section 280C(c)(3) election must claim the reduced section 41(a) credit determined by the method provided in section 280C(c)(3)(B) (as opposed to claiming no credit under former section 41(h)) on an amended return filed at any time before the expiration of the period prescribed in section 6511 of the Code for filing a claim for credit or refund of the tax imposed by chapter 1 of the Code.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not

required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is David S. Hudson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1.61-1—1.281-4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 and part 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.280C-4 also issued under 26 U.S.C. 280C(c) and 103 Stat. 2413. * * *

Par. 2. A new § 1.280C-4 is added immediately after § 1.280C-3 to read as follows:

§ 1.280C-4 Credit for increasing research activities.

(a) *In general.* The election under section 280C(c)(3) to have the provisions of section 280C(c)(1) and (2) not apply shall be made by claiming the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original return for the taxable year, filed at any time on or before the due date (including extensions) for filing the income tax return for such year. An election, once made for any taxable year, shall be irrevocable for that taxable year.

(b) *Transition rule—(1) In general.* In the case of a taxable year beginning after December 31, 1988, for which the due date (including extensions) for filing the return is on or before March 4, 1990, the election under section 280C(c)(3) shall be made by claiming the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original or amended

return for such taxable year filed on or before March 3, 1990.

(2) *Taxpayers who made an election under former section 41(b).* If a taxpayer—

(i) Prior to December 19, 1989, made an election for a taxable year described in paragraph (b)(1) of this section under section 41(b) (as it existed before it was repealed by section 7814(e) of the Revenue Reconciliation Act of 1989) by not claiming any credit allowable under section 41(a), and

(ii) Has not filed an amended return on or before March 3, 1990 claiming the full credit allowable under section 41(a), the taxpayer will be treated as having made an election under section 280C(c)(3). Therefore, the provisions of section 280C(c)(1) and (2) shall not apply in such taxable year. However, in order to obtain the benefit of the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B), such a taxpayer must claim the reduced credit on an amended return filed before the expiration of the period prescribed in section 6511 for filing a claim for credit or refund of the tax imposed by chapter 1 of the Code.

(c) *Effective date.* The provisions of this section are effective for taxable years beginning after December 31, 1988.

PART 602—[AMENDED]

Par. 3. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table “§ 1.280C-4 . . . 1545-1155”.

This Treasury decision merely prescribes the manner of making the election under section 280C(c)(3). For this reason, it is found unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Approved:

Dated: January 18, 1990.

Fred T. Goldberg, Jr.,

Commissioner of Internal Revenue.

Kenneth W. Gideon,

Assistant Secretary of the Treasury.

[FR Doc. 90-1320 Filed 1-23-90; 8:45 am]

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