DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8251]

RIN 1545-AA07

Credit for Increasing Research Activity; Correction

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction of final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8251), which was published in the Federal Register for Wednesday, May 17, 1989 (54 FR 21203). The final regulations provide rules for the credit for increasing research activities.

EFFECTIVE DATE: May 17, 1989.

FOR FURTHER INFORMATION CONTACT: David S. Hudson, (202) 535-9540 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 41 of the Tax Reform Act of 1986. The Tax Reform Act of 1986 extended the credit to amounts paid or incurred before January 1, 1989; amended the definition of qualified research for taxable years beginning after December 31, 1985; provided a separate credit with respect to certain payments to qualified organizations for basic research; and amended the credit provisions in certain other aspects. The Technical and Miscellaneous Revenue Act of 1988 extended the credit to amounts paid or incurred before January 1, 1990.

Need for Correction

As published, there was an omission in the final regulations which may prove to be misleading and is in need of clarification.

Par 1. On page 21203, column 2, in the preamble under the heading "SUPPLEMENTARY INFORMATION" and preceding the heading "Background" the following language was omitted and should have appeared:

"Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)) under control number 1545-0732. The estimated annual burden per respondent is .25 hours.

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 may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, DC 20224, and 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."

Dale D. Goode,

Federal Register Liaison Officer, Assistant Chief Counsel (Corporate).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8251]

RIN 1545-AA07

Credit for Increasing Research Activity

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final amendments to the income tax regulations to provide rules for the credit for increasing research activities. The research credit was added to the law by the Economic Recovery Tax Act of 1981. The research credit was subsequently amended by the Tax Reform Act of 1984, the Tax Reform Act of 1986, and the Technical and Miscellaneous Revenue Act of 1988. The regulations provide the public with guidance needed to comply with the applicable tax law.

EFFECTIVE DATE: These regulations are effective for amounts paid or incurred after June 30, 1981, and before January 1, 1990.

FOR FURTHER INFORMATION CONTACT: David S. Hudson, 202-566-4821 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On January 21, 1983, the Federal Register published (48 FR 2790) proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to the credit for increasing research activities. A large number of comments were received and a public hearing was held on April 14, 1983. The credit for increasing research activities was originally provided by section 44F of the Internal Revenue Code, as added by section 221 of the Economic Recovery Tax Act of 1981. Section 471(c) of the Tax Reform Act of 1984 redesignated section 44F as section 30. The Tax Reform Act of 1984 did not amend the research credit provisions substantively. Section 231 of the Tax Reform Act of 1986 redesignated section 30 as section 41. The Tax Reform Act of 1986 extended the credit to amounts paid or incurred before January 1, 1989; amended the definition of qualified research for taxable years beginning after December 31, 1985; provided a separate credit with respect to certain payments to qualified organizations for basic research; and amended the credit provisions in certain other aspects. The Technical and Miscellaneous Revenue Act of 1988 extended the credit to amounts paid or incurred before January 1, 1990.

The regulations provided in this document are promulgated under section 41 for conformity purposes. Where the law has changed the regulations contain separate provisions with their own effective dates. In general, those portions of the regulations relating to the Tax Reform Act of 1986 have been reserved.

Explanation of Provisions

Joint Ventures

Section 41 (b) (1) defines the term "qualified research expenses" as the sum of the taxpayer's in-house research expenses and the taxpayer's contract research expenses, that are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer. If the taxpayer is not carrying on the trade or business for section 162 purposes to which the research relates, then the taxpayer is not entitled to the research credit for such expenditures. In the case of partnerships the carrying on a trade or business requirement must be satisfied at the partnership level without regard to the trade or business of any partner.

Section 1.44F-2(a)(4)(ii) of the proposed regulations provided an exception to the carrying on a trade or business requirement at the partnership level in the case of certain joint ventures if all the partners are entitled to the results of the research and the following is true with respect to each partner: If the partner had carried on the research that was in fact carried on by the partnership, all the research expense paid or incurred in carrying on the research would have been paid or incurred by the partner in carrying on a trade or business of the partner. Several commentators suggested that the regulations should not require each member of the joint venture to satisfy the "carrying on" test for the particular research being performed by the joint venture. They suggested that the regulations be modified to deny the credit only to those joint venturers who do not satisfy the "carrying on" test. Section 1.41-2(a)(4)(ii) of the final regulations removes the requirement that all partners must satisfy the "carrying on" test. However, to ensure that the removal of that requirement does not lead to abuse, the final regulations add certain limitations similar to those in section 168(h)(6) relating to tax-exempt use property.

Funded Research

Section 41(d)(4)(H) provides that the term qualified research does not include any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity). Section 1.44F–4(d)(1) of the proposed regulations provided that amounts paid under any agreement that are contingent on the success of the research and thus considered to be paid for the product or result of the research are not treated as funding. Section 1.44F–4(d)(2) of the proposed regulations provided that, if a taxpayer performing research for another person retains no substantial rights in the research under the agreement providing for the research, the research is treated as fully funded, and none of the expenses paid or incurred by the taxpayer in performing the research is treated as paid or incurred for qualified research. One commentator stated that, in a case where the researcher does not retain substantial rights in the results of the research and the funder's payments are contingent on the success of the research, neither the researcher nor the funder is entitled to treat any of the expenditures as paid or incurred for qualified research. The commentator's reading of the interaction of the contingent payment and the substantial rights rules is the correct reading of the two provisions. The proposed regulations are finalized as proposed on this matter. Section 1.44F–4(d)(4) of the proposed regulations provided that independent research and development payments under certain government contracts are treated as funding the research to which the payments relate. Several commentators suggested that such payments are analogous to the recovery of overhead costs through the sale of products. The final regulations provide that such payments are not to be treated as funding except where they are properly severable from the underlying contract.

Definition of Research and Experimental Expenditures

Section 41(d)(1) provides, in part, that the term "qualified research" means research with respect to which expenditures may be treated as expenses under section 174. Section 1.174–2 of the proposed regulations that was originally proposed on January 21, 1983, included extensive clarifications of the regulations under section 174, including a clarification of the treatment of computer software.

This portion of the proposed regulations is not being finalized by this document. The proposed amendments to § 1.174–2 have been revised and superseded by a separate notice of proposed rulemaking.

Special Analyses

The amendment of the regulations proposed by notice of proposed rulemaking on January 21, 1983, and adopted by this Treasury decision is interpretative. Accordingly, the Regulatory Flexibility Act (5 U.S.C. chapter 6) did not apply to the notice of proposed rulemaking and no Regulatory Flexibility Analysis was required. The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Drafting Information

The principal author of these proposed regulations is David R. Haglund 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 1.0–1 through 1.58–8

Income taxes, Tax liability, Credits.

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 602—[AMENDED]

Paragraph 1. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

Par. 2. In the table of control numbers in § 602.101, the language "§ 1.41–4 (b) and (c)....1541–0074" is removed and the language "§ 1.41–4A (b) and (c)....1545–0074" is added in its place.

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Par. 3. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

§§ 1.41–0A through 1.41–8A (Redesignated from 1.41–0 through 1.41–8 Respectively)

Par. 4. Sections 1.41–0 through 1.41–8 are redesignated §§ 1.41–0A through 1.41–8A, respectively, and the following center heading is added to precede § 1.41–0A: "Taxable Years Beginning Before January 1, 1987".

§ 1.41–0A [Amended]

Par. 5. In § 1.41–0A as redesignated, the language "1.41–1 through –8" is removed and the language "1.41–1A through –8A" is added in its place.

§ 1.41–1A [Amended]

Par. 6. In § 1.41–1A(a) as redesignated, the language "§ 1.41–3(a)" is removed and the language "§ 1.41–3A(a)" is added in its place.

§ 1.218–0 [Amended]

Par. 7. In § 1.218–0, the language "1.41–0 through 1.41–8" is removed and the language "1.41–0A through 1.41–8A" is added in its place.

Par. 8. The following new center heading and §§ 1.41–0 through 1.41–9 are added in the appropriate places.

Taxable Years Beginning After December 31, 1986

§ 1.41–0 Table of contents.

This section lists the paragraphs contained in sections 1.41–0 through 1.41–9.

§ 1.41-1 Introduction to regulations under section 41.

Sections 1.41-2 through 1.41-9 deal only with certain provisions of section 41. The following table identifies the provisions of section 41 that are dealt with, and lists each with the section of the regulations in which it is covered:

Section of the regulations	Section of the Code
§ 1.41-2	41(b)(1)
	41(b)(2)(A)(i)
	41(b)(2)(A)(ii)
	41(b)(2)(B)
	41(b)(3)
§ 1.41-3	41(c)(2)
	41(c)(4)
§ 1.41-5	41(d)
§ 1.41-7	41(e)
§ 1.41-8	41(f)(1)
§ 1.41-9	41(f)(2)
	41(f)(3)
	41(g)

Sections 1.41-4 and 1.41-6 deal with the definition of qualified research and basic research for taxable years beginning after December 31, 1985. Section 1.41-3 also deals with the special rule in section 221(d)(2) of the Economic Recovery Tax Act of 1981 relating to taxable years overlapping the effective dates of section 41. Section 41 was formerly designated sections 30 and 44F. The regulations refer to these sections as section 41 for conformity purposes. Of course, whether section 41, 30 or 44F applies to a particular expenditure depends upon when the expenditure was paid or incurred.

§ 1.41-2 Qualified Research Expenses.

(a) *Trade or business requirement*—(1) *In general.* An in-house research expense of the taxpayer or a contract research expense of the taxpayer is a qualified research expense only if the expense is paid or incurred by the taxpayer in carrying on a trade or business of the taxpayer. The phrase "in carrying on a trade or business" has the same meaning for purposes of section 41(b)(1) as it has for purposes of section 162; thus, expenses paid or incurred in connection with a trade or business within the meaning of section 174(a) (relating to the deduction for research and experimental expenses) are not necessarily paid or incurred in carrying on a trade or business for purposes of section 41. A research expense must relate to a particular trade or business being carried on by the taxpayer at the time the expense is paid or incurred in order to be a qualified research expense. For purposes of section 41, a contract research expense of the taxpayer is not a qualified research expense if the product or result of the research is intended to be transferred to another in return for license or royalty payments and the taxpayer does not use the product of the research in the taxpayer's trade or business.

(2) *New business.* Expenses paid or incurred prior to commencing a new business (as distinguished from expanding an existing business) may be paid or incurred in connection with a trade or business but are not paid or incurred in carrying on a trade or business. Thus, research expenses paid or incurred by a taxpayer in developing a product the sale of which would constitute a new trade or business for the taxpayer are not paid or incurred in carrying on a trade or business.

(3) *Research performed for others*—(i) *Taxpayer not entitled to results.* If the taxpayer performs research on behalf of another person and retains no substantial rights in the research, that research shall not be taken into account by the taxpayer for purposes of section 41. See § 1.41-5(d)(2).

(ii) *Taxpayer entitled to results.* If the taxpayer in carrying on a trade or business performs research on behalf of other persons but retains substantial rights in the research, the taxpayer shall take otherwise qualified expenses for that research into account for purposes

of section 41 to the extent provided in § 1.41-5(d)(3).

(4) *Partnerships*—(i) *In general.* An in-house research expense or a contract research expense paid or incurred by a partnership is a qualified research expense of the partnership if the expense is paid or incurred by the partnership in carrying on a trade or business of the partnership, determined at the partnership level without regard to the trade or business of any partner.

(ii) *Special rule for certain partnerships and joint ventures.* (A) If a partnership or a joint venture (taxable as a partnership) is not carrying on the trade or business to which the research relates, then the general rule in paragraph (a)(4)(i) of this section would not allow any of such expenditures to qualify as qualified research expenses.

(B) Notwithstanding paragraph (a)(4)(ii)(A) of this section, if all the partners or venturers are entitled to make independent use of the results of the research, this paragraph (a)(4)(ii) may allow a portion of such expenditures to be treated as qualified research expenditures by certain partners or venturers.

(C) First, in order to determine the amount of credit that may be claimed by certain partners or venturers, the amount of qualified research expenditures of the partnership or joint venture is determined (assuming for this purpose that the partnership or joint venture is carrying on the trade or business to which the research relates).

(D) Second, this amount is reduced by the proportionate share of such expenses allocable to those partners or venturers who would not be able to claim such expenses as qualified research expenditures if they had paid or incurred such expenses directly. For this purpose such partners' or venturers' proportionate share of such expenses shall be determined on the basis of such partners' or venturers' share of partnership items of income or gain (excluding gain allocated under section 704(c)) which results in the largest proportionate share. Where a partner's or venturer's share of partnership items of income or gain (excluding gain allocated under section 704(c)) may vary during the period such partner or venturer is a partner or venturer in such partnership or joint venture, such share shall be the highest share such partner or venturer may receive.

(E) Third, the remaining amount of qualified research expenses is allocated among those partners or venturers who would have been entitled to claim a credit for such expenses if they had paid or incurred the research expenses in their own trade or business, in the relative proportions that such partners or venturers share deductions for expenses under section 174 for the taxable year that such expenses are paid or incurred.

(F) For purposes of section 41, research expenditures to which this paragraph (a)(4)(ii) applies shall be treated as paid or incurred directly by such partners or venturers. See § 1.41-9(a)(3)(ii) for special rules regarding these expenses.

(iii) The following examples illustrate the application of the principles contained in paragraph (a)(4)(ii) of this section.

Example (1). A joint venture (taxable as a partnership) is formed by corporations A, B, and C to develop and market a supercomputer. A and B are in the business of developing computers, and each has a 30 percent distributive share of each item of income, gain, loss, deduction, credit and basis of the joint venture. C, which is an investment banking firm, has a 40 percent distributive share of each item of income, gain, loss, deduction, credit and basis of the joint venture. The joint venture agreement provides that A's, B's and C's distributive shares will not vary during the life of the joint venture, liquidation proceeds are to be distributed in accordance with the partners' capital account balances, and any partner with a deficit in its capital account following the distribution of liquidation proceeds is required to restore the amount of such deficit to the joint venture. Assume in Year 1 that the joint venture incurs $100x of "qualified research expenses." Assume further that the joint venture cannot claim the research credit for such expenses because it is not carrying on the trade or business to which the research relates. In addition A, B, and C are all entitled to make independent use of the results of the research. First, the amount of qualified research expenses of the joint venture is $100x. Second, this amount is reduced by the proportionate share of such expenses allocable to C, the venturer which would not have been able to claim such expenses as qualified research expenditures if it had paid or incurred them directly. C's proportionate share of such expenses is $40x (40% of $100x). The reduced amount is $60x. Third, the remaining $60x of qualified research expenses is allocated between A and B in the relative proportions that A and B share deductions for expenses under section 174. A is entitled to treat $30x ((30%/(30%+30%)) $60x) as a qualified research expense. B is also entitled to treat $30x ((30%/(30%+30%)) $60x) as a qualified research expense.

Example (2). Assume the same facts as in example (1) except that the joint venture agreement provides that during the first 2 years of the joint venture, A and B are each allocated 10 percent of each item of income, gain, loss, deduction, credit and basis, and C is allocated 80 percent of each item of income, gain, loss, deduction, credit and basis. Thereafter the allocations are the same as in example (1). Assume for purposes of this example that such allocations have substantial economic effect for purposes of section 704 (b). C's highest share of such items during the life of the joint venture is 80 percent. Therefore C's proportionate share of the joint venture's qualified research expenses is $80x (80% of $100x). The reduced amount of qualified research expenses is $20x ($100x − $80x). A is entitled to treat $10x ((10%/(10%+10%)) $20x) as a qualified research expense in Year 1. B is also entitled to treat $10x ((10%/(10%+10%)) $20x) as a qualified research expense in Year 1.

(b) *Supplies and personal property used in the conduct of qualified research*—(1) *In general.* Supplies and personal property (except to the extent provided in paragraph (b)(4) of this section) are used in the conduct of qualified research if they are used in the performance of qualified services (as defined in section 41(b)(2)(B), but without regard to the last sentence thereof) by an employee of the taxpayer (or by a person acting in a capacity similar to that of an employee of the taxpayer; see example (6) of § 1.41-2(e)(5)). Expenditures for supplies or for the use of personal property that are indirect research expenditures or general and administrative expenses do not qualify as inhouse research expenses.

(2) *Certain utility charges*—(i) *In general.* In general, amounts paid or incurred for utilities such as water, electricity, and natural gas used in the building in which qualified research is performed are treated as expenditures for general and administrative expenses.

(ii) *Extraordinary expenditures.* To the extent the taxpayer can establish that the special character of the qualified research required additional extraordinary expenditures for utilities, the additional expenditures shall be treated as amounts paid or incurred for supplies used in the conduct of qualified research. For example, amounts paid for electricity used for general laboratory lighting are treated as general and administrative expenses, but amounts paid for electricity used in operating high energy equipment for qualified research (such as laser or nuclear research) may be treated as expenditures for supplies used in the conduct of qualified research to the extent the taxpayer can establish that the special character of the research required an extraordinary additional expenditure for electricity.

(3) *Right to use personal property.* The determination of whether an amount is paid to or incurred for another person for the right to use personal property in the conduct of qualified research shall be made without regard to the characterization of the transaction as a lease under section 168(f)(8) (as that

section read before it was repealed by the Tax Reform Act of 1986). See § 5c.168(f)(8)-1(b).

(4) *Use of personal property in taxable years beginning after December 31, 1985.* For taxable years beginning after December 31, 1985, amounts paid or incurred for the use of personal property are not qualified research expenses, except for any amount paid or incurred to another person for the right to use (time-sharing) computers in the conduct of qualified research. The computer must be owned and operated by someone other than the taxpayer, located off the taxpayer's premises, and the taxpayer must not be the primary user of the computer.

(c) *Qualified services*—(1) *Engaging in qualified research.* The term "engaging in qualified research" as used in section 41(b)(2)(B) means the actual conduct of qualified research (as in the case of a scientist conducting laboratory experiments).

(2) *Direct supervision.* The term "direct supervision" as used in section 41(b)(2)(B) means the immediate supervision (first-line management) of qualified research (as in the case of a research scientist who directly supervises laboratory experiments, but who may not actually perform experiments). "Direct supervision" does not include supervision by a higher-level manager to whom first-line managers report, even if that manager is a qualified research scientist.

(3) *Direct support.* The term "direct support" as used in section 41(b)(2)(B) means services in the direct support of either—

(i) Persons engaging in actual conduct of qualified research, or

(ii) Persons who are directly supervising persons engaging in the actual conduct of qualified research. For example, direct support of research includes the services of a secretary for typing reports describing laboratory results derived from qualified research, of a laboratory worker for cleaning equipment used in qualified research, of a clerk for compiling research data, and of a machinist for machining a part of an experimental model used in qualified research. Direct support of research activities does not include general administrative services, or other services only indirectly of benefit to research activities. For example, services of payroll personnel in preparing salary checks of laboratory scientists, of an accountant for accounting for research expenses, of a janitor for general cleaning of a research laboratory, or of officers engaged in supervising financial or personnel matters do not qualify as direct support of research. This is true whether general administrative personnel are part of the research department or in a separate department. Direct support does not include supervision. Supervisory services constitute "qualified services" only to the extent provided in paragraph (c)(2) of this section.

(d) *Wages paid for qualified services*—(1) *In general.* Wages paid to or incurred for an employee constitute in-house research expenses only to the extent the wages were paid or incurred for qualified services performed by the employee. If an employee has performed both qualified services and nonqualified services, only the amount of wages allocated to the performance of qualified services constitutes an in-house research expense. In the absence of another method of allocation that the taxpayer can demonstrate to be more appropriate, the amount of in-house research expense shall be determined by multiplying the total amount of wages paid to or incurred for the employee during the taxable year by the ratio of the total time actually spent by the employee in the performance of qualified services for the taxpayer to the total time spent by the employee in the performance of all services for the taxpayer during the taxable year.

(2) *"Substantially all."* Notwithstanding paragraph (d)(1) of this section, if substantially all of the services performed by an employee for the taxpayer during the taxable year consist of services meeting the requirements of section 41(b)(2)(B) (i) or (ii), then the term "qualified services" means all of the services performed by the employee for the taxpayer during the taxable year. Services meeting the requirements of section 41(b)(2)(B) (i) or (ii) constitute substantially all of the services performed by the employee during a taxable year only if the wages allocated (on the basis used for purposes of paragraph (d)(1) of this section) to services meeting the requirements of section 41(b)(2)(B) (i) or (ii) constitute at least 80 percent of the wages paid to or incurred by the taxpayer for the employee during the taxable year.

(e) *Contract research expenses*—(1) *In general.* A contract research expense is 65 percent of any expense paid or incurred in carrying on a trade or business to any person other than an employee of the taxpayer for the performance on behalf of the taxpayer of—

(i) Qualified research as defined in § 1.41-5, or

(ii) Services which, if performed by employees of the taxpayer, would constitute qualified services within the meaning of section 41(b)(2)(B).

Where the contract calls for services other than services described in this paragraph (e)(1), only 65 percent of the portion of the amount paid or incurred that is attributable to the services described in this paragraph (e)(1) is a contract research expense.

(2) *Performance of qualified research.* An expense is paid or incurred for the performance of qualified research only to the extent that it is paid or incurred pursuant to an agreement that—

(i) Is entered into prior to the performance of the qualified research,

(ii) Provides that research be performed on behalf of the taxpayer, and

(iii) Requires the taxpayer to bear the expense even if the research is not successful.

If an expense is paid or incurred pursuant to an agreement under which payment is contingent on the success of the research, then the expense is considered paid for the product or result rather than the performance of the research, and the payment is not a contract research expense. The previous sentence applies only to that portion of a payment which is contingent on the success of the research.

(3) *"On behalf of."* Qualified research is performed on behalf of the taxpayer if the taxpayer has a right to the research results. Qualified research can be performed on behalf of the taxpayer notwithstanding the fact that the taxpayer does not have exclusive rights to the results.

(4) *Prepaid amounts.* Notwithstanding paragraph (e)(1) of this section, if any contract research expense paid or incurred during any taxable year is attributable to qualified research to be conducted after the close of such taxable year, the expense so attributable shall be treated for purposes of section 41(b)(1)(B) as paid or incurred during the period during which the qualified research is conducted.

(5) *Examples.* The following examples illustrate provisions contained in paragraphs (e) (1) through (4) of this section.

Example (1). A, a cash-method taxpayer using the calendar year as the taxable year, enters into a contract with B Corporation under which B is to perform qualified research on behalf of A. The contract requires A to pay B $300x, regardless of the success of the research. In 1982, B performs all of the research, and A makes full payment of $300x under the contract. Accordingly, during the taxable year 1982, $195x (65

percent of the payment of $300x) constitutes a contract research expense of A.

Example (2). The facts are the same as in example (1), except that B performs 50 percent of the research in 1983. Of the $195x of contract research expense paid in 1982, paragraph (e)(4) of this section provides that $97.5x (50 percent of $195x) is a contract research expense for 1982 and the remaining $97.5x is contract research expense for 1983.

Example (3). The facts are the same as in example (1), except that instead of calling for a flat payment of $300x, the contract requires A to reimburse B for all expenses plus pay B $100x. B incurs expenses attributable to the research as follows:

Labor	$90x
Supplies	20x
Depreciation on equipment	50x
Overhead	40x
Total	200x

Under this agreement A pays B $300x during 1982. Accordingly, during taxable year 1982, $195x (65 percent of $300x) of the payment constitutes a contract research expense of A.

Example (4). The facts are the same as in example (3), except that A agrees to reimburse B for all expenses and agrees to pay B an additional amount of $100x, but the additional $100x is payable only if the research is successful. The research is successful and A pays B $300x during 1982. Paragraph (e)(2) of this section provides that the contingent portion of the payment is not an expense incurred for the performance of qualified research. Thus, for taxable year 1982, $130x (65 percent of the payment of $200x) constitutes a contract research expense of A.

Example (5). C conducts in-house qualified research in carrying on a trade or business. In addition, C pays D Corporation, a provider of computer services, $100x to develop software to be used in analyzing the results C derives from its research. Because the software services, if performed by an employee of C, would constitute qualified services, $65x of the $100x constitutes a contract research expense of C.

Example (6). C conducts in-house qualified research in carrying on C's trade or business. In addition, C contracts with E Corporation, a provider of temporary secretarial services, for the services of a secretary for a week. The secretary spends the entire week typing reports describing laboratory results derived from C's qualified research. C pays E $400 for the secretarial service, none of which constitutes wages within the meaning of section 41(b)(2)(D). These services, if performed by employees of C, would constitute qualified services within the meaning of section 41(b)(2)(B). Thus, pursuant to paragraph (e)(1) of this section, $260 (65 percent of $400) constitutes a contract research expense of C.

Example (7). C conducts in-house qualified research in carrying on C's trade or business. In addition, C pays F, an outside accountant, $100x to keep C's books and records pertaining to the research project. The activity carried on by the accountant does not constitute qualified research as defined in section 41(d). The services performed by the accountant, if performed by an employee of C, would not constitute qualified services (as defined in section 41(b)(2)(B)). Thus, under paragraph (e)(1) of this section, no portion of the $100x constitutes a contract research expense.

§ 1.41-3 Base period research expense.

(a) *Number of years in base period.* The term "base period" generally means the 3 taxable years immediately preceding the year for which a credit is being determined ("determination year"). However, if the first taxable year of the taxpayer ending after June 30, 1981, ends in 1981 or 1982, then with respect to that taxable year the term "base period" means the immediately preceding taxable year. If the second taxable year of the taxpayer ending after June 30, 1981, ends in 1982 or 1983, then with respect to that taxable year the term "base period" means the 2 immediately preceding taxable years.

(b) *New taxpayers.* If, with respect to any determination year, the taxpayer has not been in existence for the number of preceding taxable years that are included under paragraph (a) of this section in the base period for that year, then for purposes of paragraph (c)(1) of this section (relating to the determination of average qualified research expenses during the base period), the taxpayer shall be treated as—

(1) Having been in existence for that number of additional 12-month taxable years that is necessary to complete the base period specified in paragraph (a) of this section, and

(2) Having had qualified research expenses of zero in each of those additional years.

(c) *Definition of base period research expenses.* For any determination year, the term "base period research expenses" means the greater of—

(1) The average qualified research expenses for taxable years during the base period, or

(2) Fifty percent of the qualified research expenses for the determination year.

(d) *Special rules for short taxable years*—(1) *Short determination year.* If the determination year for which a research credit is being taken is a short taxable year, the amount taken into account under paragraph (c)(1) of this section shall be modified by multiplying that amount by the number of months in the short taxable year and dividing the result by 12.

(2) *Short base period year.* For purposes of paragraph (c)(1) of this section, if a year in the base period is a short taxable year, the qualified research expenses paid or incurred in the short taxable year are deemed to be equal to the qualified research expenses actually paid or incurred in that year multiplied by 12 and divided by the number of months in that year.

(3) *Years overlapping the effective dates of section 41 (section 41F)*—(i) *Determination years.* If a determination year includes months before July 1981, the determination year is deemed to be a short taxable year including only the months after June 1981. Accordingly, paragraph (d)(1) of this section is applied for purposes of determining the base period expenses for such year. See section 221(d)(2) of the Economic Recovery Tax Act of 1981.

(ii) *Base period years.* No adjustment is required in the case of a base period year merely because it overlaps June 30, 1981.

(4) *Number of months in a short taxable year.* The number of months in a short taxable year is equal to the number of whole calendar months contained in the year plus fractions for any partially included months. The fraction for a partially included month is equal to the number of days in the month that are included in the short taxable year divided by the total number of days in that month. Thus, if a short taxable year begins on January 1, 1982, and ends on June 9, 1982, it consists of 5 and 9/30 months.

(e) *Examples.* The following examples illustrate the application of this section.

Example (1). X Corp., an accrual-method taxpayer using the calendar year as its taxable year, is organized and begins carrying on a trade or business during 1979 and subsequently incurs qualified research expenses as follows:

1979	$10x
1980	150x
1/1/81–6/30/81	80x
7/1/81–12/31/81	110x
1982	250x
1983	450x

(i) *Determination year 1981.* For determination year 1981, the base period consists of the immediately preceding taxable year, calendar year 1980. Because the determination year includes months before July 1981, paragraph (d)(3)(i) requires that the determination year be treated as a short taxable year. Thus, for purposes of paragraph (c)(1), as modified by paragraph (d)(1), the average qualified research expenses for taxable years during the base period are $75x ($150x, the average qualified research expenses for the base period, multiplied by 6, the number of months in the determination year after June 30, 1981, and divided by 12). Because this amount is greater than the amount determined under paragraph (c)(2) (50 percent of the determination year's qualified research expense of $110x, or $55x), the amount of base period research expenses

is $75x. The credit for determination year 1981 is equal to 25 percent of the excess of $[illegible]x (the qualified research expenditures incurred during the determination year including only expenditures accrued on or after July 1, 1981, through the end of the determination year) over $75x (the base period research expenses).

(ii) *Determination year 1982.* For determination year 1982, the base period consists of the 2 immediately preceding taxable years, 1980 and 1981. The amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is $175x ([$150x+$90x+$110x]/2). This amount is greater than the amount determined under paragraph (c)(2) (50 percent of $250x, or $125x). Accordingly, the amount of base period research expenses is $175x. The credit for determination year 1982 is equal to 25 percent of the excess of $250x (the qualified research expenses incurred during the determination year) over $175x (the base period research expenses).

(iii) *Determination year 1983.* For determination year 1983, the base period consists of the 3 immediately preceding taxable years 1980, 1981 and 1982. The amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is $200x ([$150x+$200x+$250x]/3). The amount determined under paragraph (c)(2) is $225x (50 percent of the $450x of qualified research expenses in 1983). Accordingly, the amount of base period research expenses is $225x. The credit for determination year 1983 is equal to 25 percent of the excess of $450x (the qualified research expenses incurred during the determination year) over $225x (the base period research expenses).

Example (2). Y, an accrual-basis corporation using the calendar year as its taxable year comes into existence and begins carrying on a trade or business on July 1, 1983. Y incurs qualified research expenses as follows:

7/1/83—12/31/83	$80x
1984	200x
1985	200x

(i) *Determination year 1983.* For determination year 1983, the base period consists of the 3 immediately preceding taxable years: 1980, 1981 and 1982. Although Y was not in existence during 1980, 1981 and 1982, Y is treated under paragraph (b) of this section as having been in existence during those years with qualified research expenses of zero. Thus, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is $0x ([$0x+$0x+$0x]/3). The amount determined under paragraph (c)(2) of this section is $40x (50 percent of $80x). Accordingly, the amount of base period research expenses is $40x. The credit for determination year 1983 is equal to 25 percent of the excess of $80x (the qualified research expenses incurred during the determination year) over $40x (the base period research expenses).

(ii) *Determination year 1984.* For determination year 1984, the base period consists of the 3 immediately preceding taxable years, 1981, 1982, and 1983. Under paragraph (b) of this section, Y is treated as having been in existence during years 1981 and 1982 with qualified research expenses of zero. Because July 1 through December 31, 1983 is a short taxable year, paragraph (d)(2) of this section requires that the qualified research expenses for that year be adjusted to $160x for purposes of determining the average qualified research expenses during the base period. The $160x results from the actual qualified research expenses for that year ($80x) multiplied by 12 and divided by 6 (the number of months in the short taxable year). Accordingly, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is $53⅓x ([$0x+$0x+$160x]/3). The amount determined under paragraph (c)(2) of this section is $100x (50 percent of $200x). The amount of base period research expenses is $100x. The credit for determination year 1984 is equal to 25 percent of the excess of $200x (the qualified research expenses incurred during the determination year) over $100x (the base period research expenses).

(iii) *Determination year 1985.* For determination year 1985, the base period consists of the 3 immediately preceding taxable years: 1982, 1983, and 1984. Pursuant to paragraph (b) of this section, Y is treated as having been in existence during 1982 with qualified research expenses of zero. Because July 1 through December 31, 1982, is a short taxable year, paragraph (d)(2) of this section requires that the qualified research expense for that year be adjusted to $160x for purposes of determining the average qualified research expenses for taxable years during the base period. This $160x is the actual qualified research expense for that year ($80x) multiplied by 12 and divided by 6 (the number of months in the short taxable year). Accordingly, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is $120x ([$0x+$160x+$200x]/3). The amount determined under paragraph (c)(2) of this section is $100x (50 percent of $200x). The amount of base period research expenses is $120x. The credit for determination year 1985 is equal to 25 percent of the excess of $200x (the qualified research expenses incurred during the determination year) over $120x (the base period research expenses).

§ 1.41-4 Qualified research for taxable years beginning after December 31, 1985. [Reserved]

§ 1.41-5 Qualified research for taxable years beginning before January 1, 1986.

(a) *General rule.* Except as otherwise provided in section 30(d) (as that section read before amendment by the Tax Reform Act of 1986) and in this section, the term "qualified research" means research, expenditures for which would be research and experimental expenditures within the meaning of section 174. Expenditures that are ineligible for the section 174 deduction elections are not expenditures for qualified research. For example, expenditures for the acquisition of land or depreciable property used in research, and mineral exploration costs described in section 174(d), are not expenditures for qualified research.

(b) *Activities outside the United States*—(1) *In-house research.* In-house research conducted outside the United States (as defined in section 7701(a)(9)) cannot constitute qualified research. Thus, wages paid to an employee scientist for services performed in a laboratory in the United States and in a test station in Antarctica must be apportioned between the services performed within the United States and the services performed outside the United States, and only the wages apportioned to the services conducted within the United States are qualified research expenses unless the 80 percent rule of § 1.41-2(d)(2) applies.

(2) *Contract research.* If contract research is performed partly within the United States and partly without, only 65 percent of the portion of the contract amount that is attributable to the research performed within the United States can qualify as contract research expense (even if 80 percent or more of the contract amount was for research performed in the United States).

(c) *Social sciences or humanities.* Qualified research does not include research in the social sciences or humanities. For purposes of section 30(d)(2) (as that section read before amendment by the Tax Reform Act of 1986) and of this section, the phrase "research in the social sciences or humanities" encompasses all areas of research other than research in a field of laboratory science (such as physics or biochemistry), engineering or technology. Examples of research in the social sciences or humanities include the development of a new life insurance contract, a new economic model or theory, a new accounting procedure or a new cookbook.

(d) *Research funded by any grant, contract, or otherwise*—(1) *In general.* Research does not constitute qualified research to the extent it is funded by any grant, contract, or otherwise by another person (including any governmental entity). All agreements (not only research contracts) entered into between the taxpayer performing the research and other persons shall be considered in determining the extent to which the research is funded. Amounts payable under any agreement that are contingent on the success of the research and thus considered to be paid for the product or result of the research (see § 1.41-2(e)(2)) are not treated as

funding. For special rules regarding funding between commonly controlled businesses, see § 1.41–6(e).

(2) *Research in which taxpayer retains no rights.* If a taxpayer performing research for another person retains no substantial rights in research under the agreement providing for the research, the research is treated as fully funded for purposes of section 41(d)(4)(H), and no expenses paid or incurred by the taxpayer in performing the research are qualified research expenses. For example, if the taxpayer performs research under an agreement that confers on another person the exclusive right to exploit the results of the research, the taxpayer is not performing qualified research because the research is treated as fully funded under this paragraph (d)(2). Incidental benefits to the taxpayer from performance of the research (for example, increased experience in a field of research) do not constitute substantial rights in the research. If a taxpayer performing research for another person retains no substantial rights in the research and if the payments to the researcher are contingent upon the success of the research, neither the performer nor the person paying for the research is entitled to treat any portion of the expenditures as qualified research expenditures.

(3) *Research in which the taxpayer retains substantial rights*—(i) *In general.* If a taxpayer performing research for another person retains substantial rights in the research under the agreement providing for the research, the research is funded to the extent of the payments (and fair market value of any property) to which the taxpayer becomes entitled by performing the research. A taxpayer does not retain substantial rights in the research if the taxpayer must pay for the right to use the results of the research. Except as otherwise provided in paragraph (d)(3)(ii) of this section, the taxpayer shall reduce the amount paid or incurred by the taxpayer for the research that would, but for section 41(d)(4)(H), constitute qualified research expenses of the taxpayer by the amount of funding determined under the preceding sentence.

(ii) *Pro rata allocation.* If the taxpayer can establish to the satisfaction of the district director—

(A) The total amount of research expenses,

(B) That the total amount of research expenses exceed the funding, and

(C) That the otherwise qualified research expenses (that is, the expenses which would be qualified research expenses if there were no funding) exceed 65 percent of the funding, then the taxpayer may allocate the funding pro rata to nonqualified and otherwise qualified research expenses, rather than allocating it 100 percent to otherwise qualified research expenses (as provided in paragraph (d)(3)(i) of this section). In no event, however, shall less than 65 percent of the funding be applied against the otherwise qualified research expenses.

(iii) *Project-by-project determination.* The provisions of this paragraph (d)(3) shall be applied separately to each research project undertaken by the taxpayer.

(4) *Independent research and development under the Federal Acquisition Regulations System and similar provisions.* The Federal Acquisition Regulations System and similar rules and regulations relating to contracts (fixed price, cost plus, etc.) with government entities provide for allocation of certain "independent research and development costs" and "bid and proposal costs" of a contractor to contracts entered into with that contractor. In general, any "independent research and development costs" and "bid and proposal costs" paid to a taxpayer by reason of such a contract shall not be treated as funding the underlying research activities except to the extent the "independent research and development costs" and "bid and proposal costs" are properly severable from the contract. See § 1.451–3(e); see also section 804(d)(2) of the Tax Reform Act of 1986.

(5) *Funding determinable only in subsequent taxable year.* If at the time the taxpayer files its return for a taxable year, it is impossible to determine to what extent particular research performed by the taxpayer during that year may be funded, then the taxpayer shall treat the research as completely funded for purposes of completing that return. When the amount of funding is finally determined, the taxpayer should amend the return and any interim returns to reflect the proper amount of funding.

(6) *Examples.* The following examples illustrate the application of the principles contained in this paragraph.

Example (1). A enters into a contract with B Corporation, a cash-method taxpayer using the calendar year as its taxable year, under which B is to perform research that would, but for section 41(d)(3)(H), be qualified research of B. The agreement calls for A to pay B $120x, regardless of the outcome of the research. In 1982, A makes full payment of $120x under the contract, B performs all the research, and B pays all the expenses connected with the research, as follows:

In-house research expenses	$100x
Outside research:	
(Amount B paid to third parties for research, 65 percent of which ($26x) is treated as a contract research expense of B)	40x
Overhead and other expenses	10x
Total	150x

If B has no rights to the research, B is fully funded. Alternatively, assume that B retains the right to use the results of the research in carrying on B's business. Of B's otherwise qualified research expenses of $126x + $26x), $120x is treated as funded by A. Thus $6x ($120x − $120x) is treated as a qualified research expense of B. However, if B establishes the facts required under paragraph (d)(3) of this section, B can allocate the funding pro rata to nonqualified and otherwise qualified research expenses. Thus $100.8x ($120x ($126x/$150x)) would be allocated to otherwise qualified research expenses. B's qualified research expenses would be $25.2x ($126x − $100.8x). For purposes of the following examples (2), (3) and (4) assume that B retains substantial rights to use the results of the research in carrying on B's business.

Example (2). The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, although A makes full payment of $120x during 1982, B does not perform the research or pay the associated expenses until 1983. The computations are unchanged. However, B's qualified research expenses determined in example (1) are qualified research expenses during 1983.

Example (3). The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, although B performs the research and pays the associated expenses during 1982, A does not pay the $120x until 1983. The computations are unchanged and the amount determined in example (1) is a qualified research expense of B during 1982.

Example (4). The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, instead of agreeing to pay B $120x, A agrees to pay $100x regardless of the outcome and an additional $20x only if B's research produces a useful product. B's research produces a useful product and A pays B $120x during 1982. The $20x payment that is conditional on the success of the research is not treated as funding. Assuming that B establishes to the satisfaction of the district director the actual research expenses, B can allocate the funding to nonqualified and otherwise qualified research expenses. Thus $84x ($100x ($126x/$150x)) would be allocated to otherwise qualified research expenses. B's qualified research expenses would be $42x ($126x − $84x).

Example (5). C enters into a contract with D, a cash-method taxpayer using the calendar year as its taxable year, under which D is to perform research in which both C and D will

have substantial rights. C agrees to reimburse D for 80 percent of D's expenses for the research. D performs part of the research in 1982 and the rest in 1983. At the time that D files its return for 1982, D is unable to determine the extent to which the research is funded under the provisions of this paragraph. Under these circumstances, D may not treat any of the expenses paid by D for this research during 1982 as qualified research expenses on its 1982 return. When the project is complete and D can determine the extent of funding, D should file an amended return for 1982 to take into account any qualified research expense for 1982.

§ 1.41-6 Basic research for taxable years beginning after December 31, 1985.

[Reserved]

§ 1.41-7 Basic research for taxable years beginning before January 1, 1986.

(a) *In general.* The amount expended for basic research within the meaning of section 30(e) (before amended by the Tax Reform Act of 1986) equals the sum of money plus the taxpayer's basis in tangible property (other than land) transferred for use in the performance of basic research.

(b) *Trade or business requirement.* Any amount treated as a contract research expense under section 30(e) (before amendment by the Tax Reform Act of 1986) shall be deemed to have been paid or incurred in carrying on a trade or business, if the corporation that paid or incurred the expenses is actually engaged in carrying on some trade or business.

(c) *Prepaid amounts*—(1) In general. If any basic research expense paid or incurred during any taxable year is attributable to research to be conducted after the close of such taxable year, the expense so attributable shall be treated for purposes of section 30(b)(1)(B) (before amendment by the Tax Reform Act of 1986) as paid or incurred during the period in which the basic research is conducted.

(2) *Transfers of property.* In the case of transfers of property to be used in the performance of basic research, the research in which that property is to be used shall be considered to be conducted ratably over a period beginning on the day the property is first so used and continuing for the number of years provided with respect to property of that class under section 168(c)(2) (before amendment by the Tax Reform Act of 1986). For example, if an item of property which is 3-year property under section 168(c) is transferred to a university for basic research on January 12, 1983, and is first so used by the university on March 1, 1983, then the research in which that property is used is considered to be conducted ratably from March 1, 1983, through February 28, 1986.

(d) *Written research agreement*—(1) *In general.* A written research agreement must be entered into prior to the performance of the basic research.

(2) *Agreement between a corporation and a qualified organization after June 30, 1983*—(i) *In general.* A written research agreement between a corporation and a qualified organization (including a qualified fund) entered into after June 30, 1983, shall provide that the organization shall inform the corporation within 60 days after the close of each taxable year of the corporation what amount of funds provided by the corporation pursuant to the agreement was expended on basic research during the taxable year of the corporation. In determining amounts expended on basic research, the qualified organization shall take into account the exclusions specified in section 30(e)(3) (before amendment by the Tax Reform Act of 1986) and in paragraph (e) of this section.

(ii) *Transfers of property.* In the case of transfers of property to be used in basic research, the agreement shall provide that substantially all use of the property is to be for basic research, as defined in section 30(e)(3) (before amendment by the Tax Reform Act of 1986).

(3) *Agreement between a qualified fund and a qualified educational organization after June 30, 1983.* A written research agreement between a qualified fund and a qualified educational organization (see section 30(e)(4)(B)(iii) (before amendment by the Tax Reform Act of 1986)) entered into after June 30, 1983, shall provide that the qualified educational organization shall furnish sufficient information to the qualified fund to enable the qualified fund to comply with the written research agreements it has entered into with grantor corporations, including the requirement set forth in paragraph (d)(2) of this section.

(e) *Exclusions*—(1) *Research conducted outside the United States.* If a taxpayer pays or incurs an amount for basic research to be performed partly within the United States and partly without, only 65 percent of the portion of the amount attributable to research performed within the United States can be treated as a contract research expense (even if 80 percent or more of the contract amount was for basic research performed in the United States).

(2) *Research in the social sciences or humanities.* Basic research does not include research in the social sciences or humanities, within the meaning of § 1.41-5(c).

(f) *Procedure for making an election to be treated as a qualified fund.* In order to make an election to be treated as a qualified fund within the meaning of section 30(e)(4)(B)(iii) (before amendment by the Tax Reform Act of 1986) or as an organization described in section 41(e)(6)(D), the organization shall file with the Internal Revenue Service center with which it files its annual return a statement that—

(1) Sets out the name, address, and taxpayer identification number of the electing organization (the "taxpayer") and of the organization that established and maintains the electing organization (the "controlling organization"),

(2) Identifies the election as an election under section 41(e)(6)(D) of the Code,

(3) Affirms that the controlling organization and the taxpayer are section 501(c)(3) organizations,

(4) Provides that the taxpayer elects to be treated as a private foundation for all Code purposes other than section 4940,

(5) Affirms that the taxpayer satisfies the requirement of section 41(e)(6)(D)(iii), and

(6) Specifies the date on which the election is to become effective.

If an election to be treated as a qualified fund is filed before February 1, 1982, the election may be made effective as of any date after June 30, 1981, and before January 1, 1986. If an election is filed on or after February 1, 1982, the election may be made effective as of any date on or after the date on which the election is filed.

§ 1.41-8 Aggregation of expenditures.

(a) *Controlled group of corporations; trades or businesses under common control*—(1) *In general.* In determining the amount of research credit allowed with respect to a trade or business that at the end of its taxable year is a member of a controlled group of corporations or a member of a group of trades or businesses under common control, all members of the group are treated as a single taxpayer and the credit (if any) allowed to the member is determined on the basis of its proportionate share (if any) of the increase in qualified research expenses of the aggregated group.

(2) *Definition of trade or business.* For purposes of this section, a trade or business is a sole proprietorship, a partnership, a trust, an estate, or a corporation that is carrying on a trade or business (within the meaning of section 162). For purposes of this section, any corporation that is a member of a

commonly controlled group shall be deemed to be carrying on a trade or business if any other member of that group is carrying on any trade or business.

(3) *Determination of common control.* For rules for determining whether trades or businesses are under common control, see paragraphs (b)–(g) of § 1.52–1 except that the words "singly or" in § 1.52–1(d)(1)(i) shall be treated as deleted.

(4) *Examples.* The following examples illustrate provisions of this paragraph.

Example (1). (i) *Facts.* A controlled group of four corporations (all of which are calendar-year taxpayers) had qualified research expenses ("research expenses") during the base period and taxable year as follows:

Corporation	Base period (average)	Taxable year	Change
A	$60	$40	($20)
B	10	15	5
C	30	70	40
D	15	25	10

(ii) *Total credit.* Because the research expenses of the four corporations are treated as if made by one taxpayer, the total amount of incremental expenses eligible for the credit is $35 ($55 increase attributable to B, C, and D less $20 decrease attributable to A). The total amount of credit allowable to members of the group is 20% of the incremental amount or $7.00.

(iii) *Allocation of credit.* No amount of credit is allocated to A since A's research expenses did not increase in the taxable year. The $7.00 credit is allocated to B, C, and D, the members of the group that increased their research expenses. This allocation is made on the basis of the ratio of each corporation's increase in its research expenses to the sum of increases in those expenses. Inasmuch as the total increase made by those members of the group whose research expenses rose (B, C, and D) was $55, B's share of the $7.00 credit is 5/55; C's share is 40/55; and D's share is 10/55.

Example (2). The facts are the same as in example (1) except that A had zero research expenses in the taxable year. Thus, the controlled group had a decrease rather than an increase in aggregate research expenses. Accordingly, no amount of credit is allowable to any member of the group even though B, C, and D actually increased their research expenses in comparison with their own base period expenses.

(b) *Minimum base period research expenses.* For purposes of this section, the rule in section 41(c)(3) (pertaining to minimum base period research expenses) shall be applied only to the aggregate amount of base period research expenses. See the treatment of corporation C in example (1) of paragraph (a)(4) of this section.

(c) *Tax accounting periods used*—(1) *In general.* The credit allowable to a member of a controlled group of corporations or of a group of trades or businesses under common control is that member's share of the aggregate credit computed as of the end of such member's taxable year. In computing the aggregate credit in the case of a group whose members have different taxable years, a member shall generally treat the taxable year of another member that ends with or within the determination year of the computing member as the determination year of that other member. The base period research expenses taken into account with respect to a determination year of another member shall be the base period research expenses determined for that year under § 1.41–3, except that § 1.41–3(c)(2) shall be applied only at the aggregate level.

(2) *Special rule where timing of research is manipulated.* If the timing of research by members using different tax accounting periods is manipulated to generate a credit in excess of the amount that would be allowable if all members of the group used the same tax accounting period, the district director may require each member of the group to calculate the credit in the current taxable year and all future years as if all members of the group had the same taxable year and base period as the computing member.

(d) *Membership during taxable year in more than one group.* A trade or business may be a member of only one group for a taxable year. If, without application of this paragraph, a business would be a member of more than one group at the end of its taxable year, the business shall be treated as a member of the group in which it was included for its preceding taxable year. If the business was not included for its preceding taxable year in any group in which it could be included as of the end of its taxable year, the business shall designate in its timely filed (including extensions) return the group in which it is being included. If the return for a taxable year is due before July 1, 1983, the business may designate its group membership through an amended return for that year filed on or before June 30, 1983. If the business does not so designate, then the district director with audit jurisdiction of the return will determine the group in which the business is to be included.

(e) *Intra-group transactions*—(1) *In general.* Because all members of a group under common control are treated as a single taxpayer for purposes of determining the research credit, transfers between members of the group are generally disregarded.

(2) *In-house research expenses.* If one member of a group performs qualified research on behalf of another member, the member performing the research shall include in its qualified research expenses any in-house research expenses for that work and shall not treat any amount received or accrued as funding the research. Conversely, the member for whom the research is performed shall not treat any part of any amount paid or incurred as a contract research expense. For purposes of determining whether the in-house research for that work is qualified research, the member performing the research shall be treated as carrying on any trade or business carried on by the member on whose behalf the research is performed.

(3) *Contract research expenses.* If a member of a group pays or incurs contract research expenses to a person outside the group in carrying on the member's trade or business, that member shall include those expenses as qualified research expenses. However, if the expenses are not paid or incurred in carrying on any trade or business of that member, those expenses may be taken into account as contract research expenses by another member of the group provided that the other member—

(i) Reimburses the member paying or incurring the expenses, and

(ii) Carries on a trade or business to which the research relates.

(4) *Lease Payments.* The amount paid or incurred to another member of the group for the lease of personal property owned by a member of the group is not taken into account for purposes of section 41. Amounts paid or incurred to another member of the group for the lease of personal property owned by a person outside the group shall be taken into account as in-house research expenses for purposes of section 41 only to the extent of the lesser of—

(i) The amount paid or incurred to the other member, or

(ii) The amount of the lease expenses paid to the person outside the group.

(5) *Payment for supplies.* Amounts paid or incurred to another member of the group for supplies shall be taken into account as in-house research expenses for purposes of section 41 only to the extent of the lesser of—

(i) The amount paid or incurred to the other member, or

(ii) The amount of the other member's basis in the supplies.

§ 1.41–9 Special rules.

(a) *Allocations*—(1) *Corporation making an election under subchapter S*—(i) *Pass-through, for taxable years beginning after December 31, 1982, in the case of an S corporation.* In the case of an S corporation (as defined in section 1361) the amount of research credit computed for the corporation shall be allocated to the shareholders according to the provisions of section 1366 and section 1377.

(ii) *Pass-through, for taxable years beginning before January 1, 1983, in the case of a subchapter S corporation.* In the case of an electing small business corporation (as defined in section 1371 as that section read before the amendments made by the Subchapter S Revision Act of 1982), the amount of the research credit computed for the corporation for any taxable year shall be apportioned pro rata among the persons who are shareholders of the corporation on the last day of the corporation's taxable year.

(2) *Pass-through in the case of an estate or trust.* In the case of an estate or trust, the amount of the research credit computed for the estate or trust for any taxable year shall be apportioned among the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each.

(3) *Pass-through in the case of a partnership*—(i) *In general.* In the case of a partnership, the research credit computed for the partnership for any taxable year shall be apportioned among the persons who are partners during the taxable year in accordance with section 704 and the regulations thereunder. See, for example, § 1.704–1(b)(4)(ii). Because the research credit is an expenditure-based credit, the credit is to be allocated among the partners in the same proportion as section 174 expenditures are allocated for the year.

(ii) *Certain expenditures by joint ventures.* Research expenses to which § 1.41–2(a)(4)(ii) applies shall be apportioned among the persons who are partners during the taxable year in accordance with the provisions of that section. For purposes of section 41, these expenses shall be treated as paid or incurred directly by the partners rather than by the partnership. Thus, the partnership shall disregard these expenses in computing the credit to be apportioned under paragraph (a)(3)(i) of this section, and in making the computations under section 41 each partner shall aggregate its distributive share of these expenses with other research expenses of the partner. The limitation on the amount of the credit set out in section 41(g) and in paragraph (c) of this section shall not apply because the credit is computed by the partner, not the partnership.

(4) *Year in which taken into account.* An amount apportioned to a person under this paragraph shall be taken into account by the person in the taxable year of such person which or within which the taxable year of the corporation, estate, trust, or partnership (as the case may be) ends.

(5) *Credit allowed subject to limitation.* The credit allowable to any person to whom any amount has been apportioned under paragraph (a)(1), (2) or (3)(i) of this section is subject to section 41(g) and sections 38 and 39 of the Code, if applicable.

(b) *Adjustments for certain acquisitions and dispositions—Meaning of terms.* For the meaning of "acquisition," "separate unit," and "major portion," see paragraph (b) of § 1.52–2. An "acquisition" includes an incorporation or a liquidation.

(c) *Special rule for pass-through of credit.* The special rule contained in section 41(g) for the pass-through of the credit in the case of an individual who owns an interest in an unincorporated trade or business, is a partner in a partnership, is a beneficiary of an estate or trust, or is a shareholder in an S corporation shall be applied in accordance with the principles set forth in § 1.53–3.

(d) *Carryback and carryover of unused credits.* The taxpayer to whom the credit is passed through under paragraph (c) of this section shall not be prevented from applying the unused portion in a carryback or carryover year merely because the entity that earned the credit changes its form of conducting business.

Lawrence B. Gibbs,
Commissioner of Internal Revenue.

Approved: April 6, 1989.

John G. Wilkins,
Acting Assistant Secretary of the Treasury.

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which the limitation provided under para[g]raph (1)(A) for such taxable year exceeds the sum of—

(i) the credit allowable under this section for such taxable year, and

(ii) the amounts which, by reason of this paragraph, are added to the amount allowable for such taxable year and which are attributable to taxable years preceding the unused credit year.

(3) Certain Regulated Companies.—No credit attributable to compensation taken into account for the ratemaking purposes involved shall be allowed under this section to a taxpayer if—

(A) the taxpayer's cost of service for ratemaking purposes or in its regulated books of accounts is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to a tax credit employee stock ownership plan which meets the requirements of section 409A;

(B) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan; or

(C) any portion of the amount of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.

Under regulations prescribed by the Secretary [sic], rules similar to the rules of paragraphs (4) and (7) of section 46(f) shall apply for purposes of the preceding sentence.

The above amendment applies to tax years beginning after December 31, 1982, and to carrybacks from such years.

P.L. 98-369, § 491(e)(2):

Act Sec. 491(e)(2) amended former Code Sec. 44G(c)(1)(A)(ii) by striking out "section 409A" and inserting in lieu thereof "section 409".

The above amendment is effective January 1, 1984.

P.L. 98-369, § 491(e)(3):

Act Sec. 491(e)(3) amended former Code Sec. 44G(c)(6) by striking out "section 409A(1)" and inserting in lieu thereof "section 409(1)".

The above amendment is effective January 1, 1984.

Act Sec. 18(b) provides:

(b) Special Rule for Section 14.—The amendment made by section 14 shall not apply in the case of a tax credit employee stock ownership plan if—

(1) such plan was favorably approved on September 23, 1983, by employees, and

(2) not later than January 11, 1984, the employer of such employees was 100 percent owned by such plan.

P.L. 97-448, § 103(g)(1):

Amended Code Sec. 44G(b)(3) by striking out "No credit" and inserting in lieu thereof "No credit attributable to compensation taken into account for the ratemaking purposes involved", and by adding the sentence at the end thereof. Effective as if such amendment had been included in the provision of P.L. 97-34 to which it relates.

P.L. 97-34, § 331(a):

Added Code Sec. 44G to read as above, applicable to aggregate compensation (within the meaning of Code Sec. 415(c)(3)), paid or accrued after December 31, 1982, in taxable years ending after such date.

[Sec. 41]

SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

[Sec. 41(a)]

(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 period research expenses, and

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

[Sec. 41(b)]

(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 TARGETED JOBS CREDIT APPLIES.—The term "wages" shall not include any amount taken into account in determining the targeted jobs 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.

[Sec. 41(c)]

(c) BASE PERIOD RESEARCH EXPENSES.—For purposes of this section—

(1) IN GENERAL.—The term "base period research expenses" means the average of the qualified research expenses for each year in the base period.

(2) BASE PERIOD.—

(A) IN GENERAL.—For purposes of this subsection, the term "base period" means the 3 taxable years immediately preceding the taxable year for which the determination is being made (hereinafter in this subsection referred to as the "determination year").

(B) TRANSITIONAL RULES.—Subparagraph (A) shall be applied—

(i) by substituting "first taxable year" for "3 taxable years" in the case of the first determination year ending after June 30, 1981, and

(ii) by substituting "2" for "3" in the case of the second determination year ending after June 30, 1981.

(3) MINIMUM BASE PERIOD RESEARCH EXPENSES.—In no event shall the base period research expenses be less than 50 percent of the qualified research expenses for the determination year.

[Sec. 41(d)]

(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.

(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).

[Sec. 41(e)]

(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).

(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, for purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 1987.

(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 period research expenses 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)).

[Sec. 41(f)]

(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 its proportionate share of the increase in qualified research expenses giving rise to the credit.

(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 its proportionate share of the increase in qualified research expenses giving rise to the credit.

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.—If, after June 30, 1980, a taxpayer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the "predecessor") or the major portion of a separate unit of a trade or business of a predecessor,

then, for purposes of applying this section for any taxable year ending after such acquisition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such acquisition shall be increased by so much of such expenses paid or incurred by the predecessor with respect to the acquired trade or business as is attributable to the portion of such trade or business or separate unit acquired by the taxpayer.

(B) DISPOSITIONS.—If, after June 30, 1980—

(i) a taxpayer disposes of the major portion of any trade or business or the major portion of a separate unit of a trade or business in a transaction to which subparagraph (A) applies, and

(ii) the taxpayer furnished 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 the taxpayer during periods before such disposition shall be decreased by so much of such expenses as is attributable to the portion of such trade or business or separate unit disposed of by the taxpayer.

(C) INCREASE IN BASE PERIOD.—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 base period for such taxable year shall be increased by the lesser of—

(i) the amount of the decrease under subparagraph (B) which is allocable to such base period, or

(ii) the product of the number of years in the base period, 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 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.

[Sec. 41(g)]

(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.

[Sec. 41(h)]

(h) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred after December 31, 1988.

(2) COMPUTATION OF BASE PERIOD EXPENSES.—In the case of any taxable year which begins before January 1, 1989, and ends after December 31, 1988, any amount for any base period with respect to such taxable year shall be the amount which bears the same ratio to such amount for

such base period as the number of days in such taxable year before January 1, 1989, bears to the total number of days in such taxable year.

Amendments

P.L. 99-514, § 231(a)(1):

Act Sec. 231(a)(1) added Code Sec. 30(h), now redesignated as Code Sec. 41, to read as above.

The above amendment applies to tax years ending after December 31, 1985.

P.L. 99-514, § 231(b):

Act Sec. 231(b) amended Code Sec. 30(d), now redesignated as Code Sec. 41, to read as above. Prior to amendment, Code Sec. 30(d) read as follows:

(d) QUALIFIED RESEARCH.—For purposes of this section the term "qualified research" has the same meaning as the term research or experimental has under section 174, except that such term shall not include—

(1) qualified research conducted outside the United States,

(2) qualified research in the social sciences or humanities, and

(3) qualified research to the extent funded by any grant, contract, or otherwise by another person (or any governmental entity).

The above amendment applies to tax years beginning after December 31, 1985.

P.L. 99-514, § 231(c)(1):

Act Sec. 231(c)(1) amended Code Sec. 30(a), now redesignated as Code Sec. 41, to read as above. Prior to amendment, Code Sec. 30(a) read as follows:

(a) GENERAL RULE.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 25 percent of the excess (if any) of—

(1) the qualified research expenses for the taxable year, over

(2) the base period research expenses.

The above amendment applies to tax years beginning after December 31, 1985. However, for a special rule, see Act Sec. 231(g)(3), below.

Act Sec. 231(g)(3) provides:

(3) BASIC RESEARCH.—Section 41(a)(2) of the Internal Revenue Code of 1986 (as added by this section), and the amendments made by subsection (c)(2), shall apply to taxable years beginning after December 31, 1986.

P.L. 99-514, § 231(c)(2):

Act Sec. 231(c)(2) amended Code Sec. 30(e), now redesignated as Code Sec. 41, to read as above. Prior to amendment, Code Sec. 30(e) read as follows:

(e) CREDIT AVAILABLE WITH RESPECT TO CERTAIN BASIC RESEARCH BY COLLEGES, UNIVERSITIES, AND CERTAIN RESEARCH ORGANIZATIONS.—

(1) IN GENERAL.—65 percent of any amount paid or incurred by a corporation (as such term is defined in section 170(e)(4)(D)) to any qualified organization for basic research to be performed by such organization shall be treated as contract research expenses. The preceding sentence shall apply only if the amount is paid or incurred pursuant to a written research agreement between the corporation and the qualified organization.

(2) QUALIFIED ORGANIZATION.—For purposes of this subsection, the term "qualified organization" means—

(A) any educational organization which is described in section 170(b)(1)(A)(ii) and which is an institution of higher education (as defined in section 3304(f)), and

(B) any other organization which—

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

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

(iii) is not a private foundation.

(3) 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—

(A) basic research conducted outside the United States, and

(B) basic research in the social sciences or humanities.

(4) SPECIAL RULES FOR GRANTS TO CERTAIN FUNDS.—

(A) IN GENERAL.—For purposes of this subsection, a qualified fund shall be treated as a qualified organization and the requirements of paragraph (1) that the basic research be performed by the qualified organization shall not apply.

(B) QUALIFIED FUND.—For purposes of subparagraph (A), the term "qualified fund" means any organization which—

(i) is described in section 501(c)(3) and exempt from tax under section 501(a) and is not 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 purposes of making grants pursuant to written research agreements to organizations described in paragraph (2)(A) for purposes of basic research, and

(iv) makes an election under this paragraph.

(C) EFFECT OF ELECTION.—

(i) IN GENERAL.—Any organization which makes an election under this paragraph shall be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

(ii) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, may be revoked only with the consent of the Secretary.

P.L. 99-514, § 231(d)(2):

Act Sec. 231(d)(2) transferred Code Sec. 30 to subpart D of part IV of subchapter A of chapter 1, inserted it after section 40, and redesignated it as section 41.

P.L. 99-514, § 231(d)(3)(C)(ii):

Act Sec. 231(d)(3)(C)(ii) amended Code Sec. 41(g), as redesignated by Act Sec. 231, to read as above. Prior to amendment, Code Sec. 41(g) read as follows:

(g) LIMITATION BASED ON AMOUNT OF TAX.—

(1) LIABILITY FOR TAX.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the credit allowed by subsection (a) for any taxable year shall not exceed the taxpayer's tax liability for the taxable year (as defined in section 26(b)), reduced by the sum of the credits allowable under subpart A and sections 27, 28, and 29.

(B) SPECIAL RULE FOR PASSTHROUGH OF CREDIT.—In the case of an individual who—

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

(ii) is a partner in a partnership,

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

(iv) is a shareholder in an S corporation,

the credit allowed by subsection (a) for any taxable year shall not exceed the lesser of the amount determined under subparagraph (A) for the taxable year or 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.

as (changed) and amended by Sec. 301 of ... date rule in Sec. 301(d)(1)(A) of P.L. 90-611).

SUBTITLE F—PROCEDURE AND ADMINISTRATION

CHAPTER 61—INFORMATION AND RETURNS

SUBCHAPTER A—RETURNS AND RECORDS

Part I—Records, Statements, and Special Returns

SEC. 6001. NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS.

...ny person liable for any tax imposed by this title, or for the collection thereof, shall ... such records, render such statements, make such returns and comply with such rules ... regulations as the Secretary may from time to time prescribe. Whenever in the judg... of the Secretary it is necessary, he may require any person, by notice served upon ... person or by regulations, to make such returns, render such statements, or keep ... records, as the Secretary deems sufficient to show whether or not such person is ... for tax under this title. The only records which an employer shall be required to ... under this section in connection with charged tips shall be charge receipts, records ...sary to comply with section 6053(c), and copies of statements furnished by employ... under section 6053(a).

...amendment.—Sec. 6001 appears above as ... by Sec. 314(d) of Public Law 91-258, Sept. ... 1970, effective (Sec. 314(a) of P.L. 91-258) for calendar ... years beginning after Dec. 31, 1970.

...amended by Sec. 301(c) of Public Law 91-600, Nov. 6, 1970, effective (Sec. 301(c) of P.L. 91-600) for payments made after Dec. 31, 1970. Sec. 6001 as so ... amendment is in P-H Cumulative Changes.

Implied amendment of Sec. 6001 was made by ... 310 of Public Law 98-369, July 18, 1984.

Part II—Tax Returns or Statements

Subpart A—General Requirement

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

(a) General Rule.—When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

(b) Identification of Taxpayer.—The Secretary is authorized to require such information with respect to persons subject to the taxes imposed by chapter 21 or chapter 24 as is necessary or helpful in securing proper identification of such persons.

(c) Returns, Etc., of DISC's and Former DISC's and FSC's and Former PSC's.—

(1) Records and information.—A DISC or former DISC or a FSC or former FSC shall for the taxable year—

(A) furnish such information to persons who were shareholders at any time during such taxable year, and to the Secretary, and

(B) keep such records, as may be required by regulations prescribed by the Secretary.

Last amendment.—Sec. 6011(c)(1) (formerly (c)(1)) appears above as amended by Sec. 801(a)(1)(J) of Public Law 98-369, July 18, 1984, effective (Sec. 805(a)(1) of P.L. 98-369) generally for transactions after Dec. 31, 1984, in taxable years ending after such date. Sec. 6011(c)(1) (formerly (c)(1)) as in effect before this amendment is in P-H Cumulative Changes.

Addition.—Sec. 6011(c)(1) (formerly (c)(2)) was added by Sec. 304(a) of Public Law 92-178, Dec. 10, 1971 (applicable effective date rule in Sec. 307 of P.L. 92-178).

(2) Returns.—A DISC shall file for the taxable year such returns as may be prescribed by the Secretary by forms or regulations.

Addition.—Sec. 6011(c)(2) (formerly (c)(3)) was added by Sec. 304(a) of Public Law 92-178, Dec. 10, 1971 (applicable effective date rule in Sec. 307 of P.L. 92-178).

Repealer.—Former Sec. 6011(c) was repealed by Sec. 101(b)(6) of Public Law 89-44, June 21, 1965, effective (Sec. 701(c)(1), (3) of P.L. 89-44) June 22, 1965. Sec. 6011(c) as in effect before this repealer is in P-H Cumulative Changes.

Addition.—Former Sec. 6011(c) was added by Sec. 141(a) of Public Law 85-859, Sept. 2, 1958, effective (Sec. 1(c) of P.L. 85-859) Jan. 1, 1958.

(d) Authority To Require Information Concerning Section 912 Allowances.—The Secretary may by regulations require any individual who receives allowances which are excluded from gross income under section 912 for any taxable year to include on his return of the taxes imposed by subtitle A for such taxable year such information with respect to the amount and type of such allowances as the Secretary determines to be appropriate.

Addition.—Sec. 6011(d) was added by Sec. 207(c) of Public Law 95-615, Nov. 8, 1978, effective (Sec. 209(a) of P.L. 95-615) for taxable years beginning after Dec. 31, 1977.

Former (d) [Repealed]

Prior amendments.—Former Sec. 6011(d) was amended by the following:

Sec. 4(f), (g) of Public Law 91-134, Nov. 26, 1969.

Sec. 4(b) of Public Law 90-58, July 31, 1967 effective (Sec. 4(b) of P.L. 90-58) with respect to acquisitions of stock and debt obligations made after July 14, 1967.

...Public Law 88-563, Sept. 2, 1964 (quoted ... date rule in Sec. 3(a) of P.L. 88-563) ... Sec. 3(d) of Public Law 89-713, July 29, 1966. Sec. 3(d)(1) of Public Law 89-713, Oct. 9, 1965. ... Sec. 6011(d) as so amended is in P-H Cumulative Changes.

(c) Regulations Requiring Returns of Magnetic Tape, Etc.—

(1) In general.—The Secretary shall prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form. The Secretary may not require returns of any tax imposed by subtitle A on individuals, estates, and trusts to be other than on paper forms supplied by the Secretary. In prescribing such regulations, the Secretary shall take into account (among other relevant factors) the ability of the taxpayer to comply at reasonable cost with such a filing requirement.

(2) Certain returns must be filed on magnetic media.—

(A) In general.—In the case of any person who is required to file returns under sections 6042(a), 6044(a), and 6049(a) with respect to more than 50 payees for any calendar year, all returns under such sections shall be on magnetic media.

(B) Hardship exception.—Subparagraph (A) shall not apply to any person for any period if such person establishes to the satisfaction of the Secretary that its application to such person for such period would result in undue hardship.

...amendment.—Sec. 6011(c) appears above as added by Sec. 109(a) of Public Law 95-87, Aug. 3, ... effective (Sec. 110(a) of P.L. 95-87) for payments ... after Dec. 31, 1982. Sec. 6011(c) as it read before this amendment is in P-H Cumulative Changes.

Addition.—Sec. 6011(c) was added by Sec. 319 of Public Law 97-248, Sept. 3, 1982.

(d) Income, Estate, and Gift Taxes.—

For requirement that returns of income, estate, and gift taxes be made whether or not ... is tax liability, see sections 6012 to 6019, inclusive.

...amendment.—Sec. 6011(f) (formerly (e), (d), (f), (g) and (e)) appears above as redesignated by Sec. ... of Public Law 97-248, Sept. 3, 1982.

Prior amendments.—Sec. 6011(f) (formerly Sec. 6011(e), (d), (f), (g), (d), and (g)) was amended by the following:

Sec. 301(c) of Public Law 95-615, Nov. 8, 1978, effective (Sec. 309(a) of P.L. 95-615) for taxable years be... beginning after Dec. 31, 1977.

Sec. 306(a) of Public Law 93-178, Dec. 10, 1973 (quoted) effective date rule in Sec. 301 of P.L. 93-178).*

Sec. 3(a) of Public Law 88-563, Sept. 2, 1964.*

Sec. 101(a) Public Law 85-859, Sept. 2, 1958, effective (Sec. 1(a) of P.L. 85-859) for taxable years beginning after Dec. 31, 1957.*

*Sec. 6011(f) (formerly 6011(e), (d), (f), (g), (d), and (g)) as so amended is in P-H Cumulative Changes.

Headnote changes.—Sec. 6011(c), (d) was amended by Title XIX, P.L. 94-455, 10-6-76.

Subpart B—Income Tax Returns

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

(a) General Rule.—Returns with respect to income taxes under subtitle A shall be made by the following:

(1) (A) Every individual having for the taxable year a gross income of the exemption amount or more, except that a return shall not be required of an individual (other than an individual referred to in subparagraph (C))—

(i) who is not married (determined by applying section 143), is not a surviving spouse (as defined in section 2(a)), and for the taxable year has a gross income of less than the sum of the exemption amount plus the zero bracket amount applicable to such an individual,

(ii) who is a surviving spouse (as so defined) and for the taxable year has a gross income of less than the sum of the exemption amount plus the zero bracket amount applicable to such an individual, or

...taxable year, less than the sum of twice the exemption amount plus the zero bracket amount applicable to a joint return, but only if such individual and his spouse, at the close of the taxable year, had the same household as their home.

Clause (iii) shall not apply if for the taxable year such spouse makes a separate return or any other taxpayer is entitled to an exemption for such spouse under section 151(c).

(B) The amount specified in clause (i) or (ii) of subparagraph (A) shall be increased by the exemption amount in the case of an individual entitled to an additional personal exemption under section 151(c)(1), and the amount specified in clause (iii) of subparagraph (A) shall be increased by the exemption amount for each additional personal exemption to which the individual or his spouse is entitled under section 151(c).

(C) The exception under subparagraph (A) shall not apply to—

(i) a nonresident alien individual;

(ii) a citizen of the United States entitled to the benefits of section 931;

(iii) an individual making a return under section 443(a)(1) for a period of less than 12 months on account of a change in his annual accounting period;

(iv) an individual who has income (other than earned income) of the exemption amount or more and who is described in section 63(c)(1)(D); or

(v) an estate or trust.

(D) For purposes of this paragraph—

(i) The term "zero bracket amount" has the meaning given to such term by section 63(d).

(ii) The term "exemption amount" has the meaning given to such term by section 151(d).

(2) Every corporation subject to taxation under subtitle A;

(3) Every estate the gross income of which for the taxable year is $600 or more;

(4) Every trust having for the taxable year any taxable income, or having gross income of $600 or over, regardless of the amount of taxable income;

(5) Every estate or trust of which any beneficiary is a nonresident alien; except that subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary, nonresident alien individuals subject to the tax imposed by section 871 and foreign corporations subject to the tax imposed by section 881 may be exempted from the requirement of making returns under this section.

(6) Every political organization (within the meaning of section 527(e)(1)), and every fund treated under section 527(g) as if it constituted a political organization, which has political organization taxable income (within the meaning of section 527(c)(1)) for the taxable year; and

(7) Every homeowners association (within the meaning of section 528(c)(1)) which has homeowners association taxable income (within the meaning of section 528(d)) for the taxable year.

(8) Every individual who receives payments during the calendar year in which the taxable year begins under section 3507 (relating to advance payment of earned income credit).

(9) Every estate of an individual under chapter 7 or 11 of title of the United States Code (relating to bankruptcy) the gross income of which for the taxable year is $3,700 or more.

Last amendment.—Sec. 6012(a) appears above as amended by Sec. 104(d)(1) of Public Law 97-34, Aug. 13, 1981, effective (Sec. 104(e) of P.L. 97-34) for taxable years beginning after Dec. 31, 1984.

Prior amendments.—Sec. 6012(a) was previously amended by the following:

Sec. 3(b)(1) of Public Law 96-589, Dec. 24, 1980, effective (Sec. 7(b), (g) of P.L. 96-589) for any bankruptcy case commencing more than 90 days after Dec. 24, 1980.*

Sec. 103(d) of Public Law 95-600, Nov. 6, 1978, effective (Sec. 103(d)(1) of P.L. 95-600) for taxable years beginning after Dec. 31, 1978.*

Sec. 103(b)(1) of Public Law 95-600, Nov. 6, 1978, effective (Sec. 103(d)(1) of P.L. 95-600) for taxable years beginning after Dec. 31, 1976.*

Sec. 101(c) of Public Law 95-600, Nov. 6, 1978, effective (Sec. 101(d)(1) of P.L. 95-600) for taxable years beginning after Dec. 31, 1976.

Sec. 104 of Public Law 95-30, May 23, 1977, effective (Sec. 104(e) of P.L. 95-30) for taxable years beginning after Dec. 31, 1976.*

Sec. 2101(c) of Public Law 94-455, Oct. 4, 1976, effective (Sec. 2101(e) of P.L. 94-455) for taxable years beginning after Dec. 31, 1973.*

impair any right or remedy, including trial by jury, to recover any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority, or any sum alleged to have been excessive or in any manner wrongfully collected under the internal revenue laws. For the purpose of any action to recover any such tax, penalty, or sum, all statutes, rules, and regulations relating to the collector of internal revenue, the principal officer for the internal revenue district, or the Secretary, shall be deemed to refer to the officer whose act or acts referred to in the preceding sentence give rise to such action. The venue of any such action shall be the same as under existing law.

SEC. 7805. RULES AND REGULATIONS.

(a) Authorization.—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) Retroactivity of Regulations or Rulings.—The Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

(c) Preparation and Distribution of Regulations, Forms, Stamps, and Other Matters.—The Secretary shall prepare and distribute all the instructions, regulations, directions, forms, blanks, stamps, and other matters pertaining to the assessment and collection of internal revenue.

(d) Manner of Making Elections Prescribed by Secretary.—Except to the extent otherwise provided by this title, any election under this title shall be made at such time and in such manner as the Secretary shall by regulations or forms prescribe.

Additions.—Sec. 7805(d) was added by Sec. 413(b) of ... of P.L. 98-369) for taxable years ending after July 18, Public Law 98-369, July 18, 1984, effective (Sec. 446) 1984.

SEC. 7806. CONSTRUCTION OF TITLE.

(a) Cross References.—The cross references in this title to other portions of the title, or other provisions of law, where the word "see" is used, are made only for convenience, and shall be given no legal effect.

(b) Arrangement and Classification.—No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter relating to the contents of this title be given any legal effect. The preceding sentence also applies to the indentions and ancillary tables contained in the various prints of this Act before its enactment into law.

SEC. 7807. RULES IN EFFECT UPON ENACTMENT OF THIS TITLE.

(a) Interim Provision for Administration of Title.—Until regulations are promulgated under any provision of this title which depends for its application upon the promulgation of regulations (or which is to be applied in such manner as may be prescribed by regulations) all instructions, rules or regulations which are in effect immediately prior to the enactment of this title shall, to the extent such instructions, rules, or regulations could be prescribed as regulations under authority of such provisions, be applied as if promulgated as regulations under such provision.

(b) Provisions of This Title Corresponding to Prior Internal Revenue Laws.—

(1) Reference to law applicable to prior period.—Any provision of this title which refers to the application of any portion of this title to a prior period (or which depends upon the application to a prior period of any portion of this title) shall, when appropriate and consistent with the purpose of such provision, be deemed to refer to (or depend upon the application of) the corresponding provision of the Internal Revenue Code of 1939 or of such other internal revenue laws as were applicable to the prior period.

(2) Elections or other acts.—If an election or other act under the provisions of the Internal Revenue Code of 1939 would, if this title had not been enacted, be given effect for a period subsequent to the date of enactment of this title, and if correspond-