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Baucus-Hatch bill would make permanent and simplify the research credit

Senate Finance Committee Chairman Max Baucus (D-MT) and ranking minority member Orrin Hatch (R-UT), together with eight co-sponsors, recently introduced the Greater Research Opportunities with Tax Help Act of 2011 (GROWTH Act), which would make permanent the section 41 research credit and make other important changes to the credit.

Background

Under section 41, a taxpayer may claim a research tax credit equal to 20 percent of the amount by which the taxpayer's qualified research expenditures (QREs) for a tax year exceed its "base amount" for that year. That is, the credit generally is available with respect to incremental increases in qualified research. Taxpayers also may claim a 14-percent alternative simplified credit (ASC) in lieu of the regular credit. The regular credit has been criticized for the compliance burdens it places on both taxpayers and the IRS.

The research credit, which is scheduled to expire December 31, 2011, has been extended 14 times -- in some cases retroactively -- since it was first enacted in 1981. Many observers believe that the temporary nature of the credit reduces its effectiveness. The credit's effectiveness as an incentive is further reduced when the credit is allowed to expire before being extended.

The GROWTH Act

For tax years beginning after 2011, the bill would eliminate the regular research credit and make permanent the ASC. The ASC credit rate would increase from 14 percent to 20 percent.

The GROWTH Act also would resolve the conflict between section 41(f)(3)(A) and the consolidated return provisions of section 1502 regarding the appropriate treatment of an acquired or disposed major portion of a trade or business or major portion of a separate unit of a trade or business when computing a controlled group's base amount. Under the GROWTH Act, a taxpayer acquiring a trade or business would prorate the base amount adjustment based on the number of months from the time of acquisition through the end of the controlled group's tax year and include the acquired corporation's QREs only from the acquisition date through the end of the taxpayer's tax year. The GROWTH Act would provide for similar treatment in the event of the disposition of a trade or business.

Observation: The legislation would override the holding in a 2002 IRS Chief Counsel Advice memorandum (CCA). In CCA 200234063, the IRS concluded that in the year of acquisition, a taxpayer should include all of the acquired corporation's QREs for the taxpayer's entire tax year as well as the acquired corporation's full-year base amount attributes.

In addition, the GROWTH Act would simplify the research credit allocation between controlled group members. Under the bill, the research credit would be allocated to controlled group members based on each member's proportionate share of the group's aggregate QREs.

A number of the bill's provisions -- such as the elimination of the traditional credit with its onerous base period requirements -- follow recommendations offered by the Government Accountability Office (GAO) in a November 2009 report, "The Research Tax Credit's Design and Administration Can be Improved." (See WNTS Insight, "GAO offers recommendations for strengthening research credit," December 11, 2009.)

The GROWTH Act also is in keeping with President Obama's budget proposal to permanently extend the research credit. (See WNTS Insight, "JCT expands analysis of Obama Administration proposal for permanent research credit," July 14, 2011.) However, it is unclear whether the Senate may have the opportunity to consider the bill before the credit expires. Senators Baucus and Hatch provided no timetable for considering or marking up the bill in the Finance Committee.

Text of the GROWTH Act

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