
Fiscal cliff legislation extends research credit, resolves M&A-related credit issue

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In brief

The American Taxpayer Relief Act of 2012 (the Act), signed into law by President Barack Obama on January 2, 2013, extends the section 41 research credit for two years retroactively from January 1, 2012, through December 31, 2013. The new law also resolves an issue regarding the treatment of qualified research expenditures (QREs) in the event of an acquisition or disposition of a trade or business.

The credit rates for both the regular credit, 20%, and the alternative simplified credit, 14%, remain unchanged by this credit extension.

In detail

The Act retroactively extends the research credit for a two-year period beginning January 1, 2012, through December 31, 2013. The Act also provides guidance with respect to two controlled group issues.

Acquisition- or disposition-related adjustments

The Act resolves a conflict between two IRS rulings regarding the calculation mechanics when computing a controlled group's QREs, gross receipts, and base amount in the year of acquisition or disposition of a major portion or separate unit of a trade or business.

Under the Act, a taxpayer acquiring a trade or business prorates the target's QRE's, gross receipts, and related base-period impact based on the number of days from the time of acquisition through the end of the controlled group's tax year. The Act provides a similar approach in the event of the disposition of a trade or business.

The Act also provides guidance for aligning QREs and gross receipts when the acquiring person and the acquired trade or business have different tax years.

Observations

The guidance with respect to the acquisition or disposition of a trade or business is effective for tax years beginning after December 31, 2011.

In Chief Counsel Advice memorandum (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. The guidance provided in this CCA conflicted with the subsequent ruling set forth in TAM

201034017, which provides a computation method similar to the proration method codified by the Act.

Taxpayers with facts similar to those of the CCA should consider the potential tax benefit of applying the CCA to tax years beginning before January 1, 2012.

Controlled group QREs

The Act also simplifies the research credit allocation among controlled group members. Under the Act, the research credit is allocated to controlled group members based on each member's proportionate share of the group's aggregate QREs.

Financial statement impact

Taxpayers may record the benefit of research credits earned since January 1, 2012, in the financial statement period that includes the date of enactment, January 2, 2013. For calendar-year taxpayers, the benefit of these credits will be recorded in the first quarter of the fiscal year ending December 31, 2013.

Actions to consider

Taxpayers considering acquiring or disposing of a trade or business with research activity should calculate their research credits for the year of acquisition or disposition under the new provisions to determine the impact on their research credits for tax years beginning after December 31, 2011.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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