

107TH CONGRESS  
1ST SESSION

# H. R. 2153

To provide for an election to exchange research-related tax benefits for a refundable tax credit, for the recapture of refunds in certain circumstances, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

JUNE 13, 2001

Mr. CRANE (for himself, Mr. MATSUI, Mrs. THURMAN, Mr. MCGOVERN, Mr. HOLT, and Mr. CUNNINGHAM) introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To provide for an election to exchange research-related tax benefits for a refundable tax credit, for the recapture of refunds in certain circumstances, and for other purposes.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       **SECTION 1. SHORT TITLE.**

4       This Act may be cited as the “American Break-  
5       through Research Act of 2001”.

6       **SEC. 2. FINDINGS AND PURPOSE.**

7       (a) FINDINGS.—Congress finds the following:

1           (1) American high technology industries con-  
2           duct long-term research and development on break-  
3           through medical, industrial, and agricultural tech-  
4           nologies. It is critical to the maintenance of Amer-  
5           ican competitiveness internationally that these long-  
6           term research and development projects be encour-  
7           aged.

8           (2) Such long-term research projects have the  
9           greatest potential to revolutionize whole fields of  
10          science and industry for the benefit of the standard  
11          of living of Americans and to yield solutions for crit-  
12          ical social needs, even though these solutions might  
13          not result in large sales and profits (such as “or-  
14          phan” drugs and other treatments alleviating great  
15          suffering in their recipients).

16          (3) High technology long-term research compa-  
17          nies are among the most research intensive and cap-  
18          ital-intensive companies in the world.

19          (4) High technology companies typically operate  
20          in financially challenging circumstances. While con-  
21          ducting their long-term breakthrough research these  
22          companies must often seek to endure without prod-  
23          ucts and little or no earnings. Many are small busi-  
24          nesses lacking the resources and stability of large  
25          corporations.

1           (5) In addition to the scientific and technical  
2 risks attending their long-term breakthrough re-  
3 search programs, many high technology companies  
4 must subject their technologies through lengthy and  
5 expensive regulatory reviews before they are per-  
6 mitted access to the marketplace.

7           (6) The long-term research high technology in-  
8 dustry is heavily dependent on outside sources of  
9 capital for continued research funding. The indus-  
10 try's long lead times and high levels of scientific and  
11 regulatory risk often impede access to capital.

12           (7) The longstanding national policy of Govern-  
13 ment support and tax incentives for basic research  
14 reflects a recognition that the capital marketplace  
15 tends to allocate insufficient resources to sustain the  
16 Nation's need for such basic scientific research and  
17 development.

18           (8) The current Federal income tax incentives  
19 are not working as intended in the case of many  
20 high technology companies whose research is focused  
21 on breakthrough technologies.

22           (9) These high technology companies typically  
23 incur net operating losses during their lengthy re-  
24 search and development phases and therefore receive

1 no contemporaneous benefit from these tax incen-  
2 tives.

3 (10) These tax incentives instead tend to favor  
4 investment by large, profitable companies engaged in  
5 secondary or tertiary research and development ac-  
6 tivities, and thus to discriminate against and to  
7 cause underinvestment in longer-term breakthrough  
8 technologies, a bias which is harmful to American  
9 competitiveness.

10 (11) For many research-intensive high tech-  
11 nology companies, the unusable tax deductions and  
12 credits can only be carried forward for potential use  
13 in later years, which places them at a substantial  
14 disadvantage in the capital marketplace where they  
15 must compete for capital with other companies able  
16 to use these tax incentives currently.

17 (12) A tax system that does not discriminate  
18 would ensure that these tax incentives in favor of re-  
19 search and experimentation have the same cost-re-  
20 ducing impact on companies conducting both short-  
21 term and long-term research and thus render this  
22 tax incentive program neutral with regard to short-  
23 term and long-term research objectives and minimize  
24 marketplace distortions caused by differences in tax  
25 and income status.

1           (13) Some States have recognized these short-  
2           comings in their own tax incentive programs and  
3           have adopted remedial amendments under which loss  
4           high technology companies are permitted to transfer  
5           or to exchange their State tax benefits for immediate  
6           cash payments.

7           (b) PURPOSE.—The purpose of this Act is to provide  
8           a remedy at the Federal level similar to that provided by  
9           some States under which qualifying high technology com-  
10          panies will be permitted to obtain current economic benefit  
11          from research-related tax incentives.

12       **SEC. 3. BREAKTHROUGH RESEARCH TAX INCENTIVE EX-**  
13                               **CHANGES.**

14          (a) IN GENERAL.—The Internal Revenue Code of  
15          1986 is amended by redesignating section 35 as section  
16          36 and by inserting after section 34 the following new sec-  
17          tion:

18       **“SEC. 35. BREAKTHROUGH RESEARCH CREDIT.**

19           “(a) GENERAL RULE.—There shall be allowed as a  
20          credit against the tax imposed by this subtitle an amount  
21          equal to the sum of a qualified research corporation’s dis-  
22          counted research credits and discounted research NOL’s.

23          “(b) QUALIFIED RESEARCH CORPORATION.—

24           “(1) IN GENERAL.—For the purposes of this  
25          section, the term ‘qualified research corporation’

1 means any domestic corporation subject to tax under  
2 subchapter C of this chapter—

3 “(A) which has not incurred regular tax li-  
4 ability (as defined in section 55(c)) under this  
5 chapter for a period of at least 3 consecutive  
6 taxable years (other than short taxable years)  
7 immediately prior to the commencement of the  
8 taxable year as to which any election is made  
9 under this section,

10 “(B) which has not been controlled by, or  
11 been under common control (as determined  
12 under section 267(b)) with, a corporation which  
13 has incurred regular tax liability (as so defined)  
14 under this chapter for any taxable year com-  
15 mencing during the period described in sub-  
16 paragraph (A),

17 “(C) at all times during the period de-  
18 scribed in subparagraph (A) has met the re-  
19 quirements of subsection (h), and

20 “(D) which is not the subject of any pro-  
21 ceeding under Federal or State bankruptcy or  
22 insolvency laws.

23 “(2) SPECIAL RULE.—A qualified research cor-  
24 poration, in claiming the credit provided for in this  
25 section, shall not take into account any expenditures

1 for which it is reimbursed by another taxpayer, ex-  
2 cept to the extent that the reimbursing taxpayer  
3 provides a certification to the qualified research cor-  
4 poration that—

5 “(A) the reimbursing taxpayer would be  
6 entitled to take such expenditures into account  
7 in the same manner, and

8 “(B) the reimbursing taxpayer shall not  
9 take such expenditures into account in claiming  
10 any credits under this section.

11 “(c) DEFINITIONS.—For the purposes of this  
12 section—

13 “(1) RESEARCH CREDIT.—The term ‘research  
14 credit’ means the sum of those portions of a quali-  
15 fied research corporation’s current year business  
16 credit and business credit carryforwards, as deter-  
17 mined under section 38(a), which are attributable to  
18 the credit determined under section 41 (for increases  
19 in research activities) and to the orphan drug credit  
20 determined under section 45C (for clinical testing  
21 expenses for certain drugs for rare diseases or condi-  
22 tions).

23 “(2) RESEARCH NOL.—The term ‘research  
24 NOL’ means that portion of a qualified research cor-  
25 poration’s net operating loss (as defined in section

1 172(c)) attributable to research expenditures allowed  
2 as deductions for research or experimentation activi-  
3 ties under section 174 (after the application of sec-  
4 tion 280C).

5 “(3) DISCOUNTED RESEARCH CREDIT.—The  
6 term ‘discounted research credit’ shall mean the re-  
7 search credit amounts subject to an election under  
8 this section multiplied by 75 percent.

9 “(4) DISCOUNTED RESEARCH NOL.—The term  
10 ‘discounted research NOL’ shall mean the research  
11 NOL subject to an election under this section multi-  
12 plied by 75 percent of the highest marginal tax rate  
13 in effect under section 11.

14 “(5) ORDERING RULE.—For purposes of deter-  
15 mining the portion of a taxpayer’s net operating loss  
16 that is attributable to research expenditures (within  
17 the meaning of paragraph (2)) for any taxable year,  
18 research expenditures shall be considered to be offset  
19 against the taxpayer’s gross income on a pro rata  
20 basis with all other allowable expenses and charges  
21 paid or incurred in the taxable year.

22 “(d) ELECTION TO RELINQUISH RESEARCH-RE-  
23 LATED NET OPERATING LOSSES AND TAX CREDITS FOR  
24 CASH REFUNDS.—

1           “(1) GENERAL RULE; BENEFITS ARISING IN  
2           CURRENT YEAR.—A qualified research corporation  
3           may make an election under this section to relin-  
4           quish all of its current year research NOL’s and re-  
5           search credits in exchange for cash refunds. The cor-  
6           poration shall make the election on its timely filed  
7           tax return (including extensions) for the taxable year  
8           in which the research NOL’s and research credits  
9           arise.

10           “(2) SPECIAL RULE; NET OPERATING LOSS AND  
11           UNUSED TAX CREDIT CARRYFORWARDS.—

12           “(A) IN GENERAL.—If a qualified research  
13           corporation has unabsorbed research NOL’s or  
14           research credits not subject to an election under  
15           this section, which arose in a previous taxable  
16           year and which the qualified research corpora-  
17           tion would be entitled to carry forward to a tax-  
18           able year for which it makes an election under  
19           paragraph (1), then the taxpayer shall des-  
20           ignate such research NOL carryforwards and  
21           such research credit carryforwards to be cov-  
22           ered by its election under this section.

23           “(B) LIMITATION.—For any taxable year,  
24           the amount of research NOL carryforwards and  
25           research credit carryforwards to the taxable

1 year which may be designated as covered by an  
2 election under this section shall be the greater  
3 of—

4 “(i) the average of the annual  
5 amounts of the qualified research corpora-  
6 tion’s research NOL’s and research credits  
7 arising in the 3 taxable years ending prior  
8 to the taxable year of the election, or

9 “(ii) 20 percent of the qualified re-  
10 search corporation’s research NOL  
11 carryforwards and research credit  
12 carryforwards.

13 “(3) PROCEDURES AND RECORDKEEPING BY  
14 ELECTING CORPORATION.—An election under this  
15 section may be revoked by the taxpayer only with  
16 the consent of the Secretary. Qualified research cor-  
17 porations making such an election shall provide such  
18 information in connection with such election as may  
19 be required by the Secretary and shall maintain  
20 records sufficient to permit the Secretary to identify  
21 and to audit the specific research credits and re-  
22 search NOL’s that are subject to an election under  
23 this section.

24 “(e) EXTINGUISHMENT OF RELINQUISHED TAX  
25 BENEFITS.—

1           “(1) DEDUCTIONS.—No deduction shall be al-  
2           lowed to a qualified research corporation under the  
3           alternative minimum tax provisions of section  
4           56(a)(4) or the net operating loss provisions of sec-  
5           tion 172 with respect to that portion of a net oper-  
6           ating loss for which an election under this section is  
7           in effect.

8           “(2) CREDITS.—No credit shall be allowed to a  
9           qualified research corporation under section 38(a)  
10          with respect to any credit amounts determined under  
11          section 41 or 45C for which an election under this  
12          section is in effect.

13          “(f) LIMITATION ON USE OF NONRELINQUISHED  
14          TAX BENEFITS BY ELECTING CORPORATION.—A quali-  
15          fied research corporation which has received refunds pur-  
16          suant to an election under this section shall not be entitled  
17          to utilize any carrybacks or carryforwards of net operating  
18          losses or tax credits (which are not subject to an election  
19          under this section and are otherwise available to be uti-  
20          lized in the taxable year) to reduce taxable income or to  
21          offset any tax liability for taxable years after the year of  
22          such election, until such corporation has paid tax imposed  
23          under this chapter for such taxable years in an aggregate  
24          amount equal to the aggregate amount of the refunds pre-

1 viously received, less any underpayment amount deter-  
2 mined under subsection (g).

3 “(g) CREDIT PROCEEDS FROM EXCHANGE OF RE-  
4 SEARCH CREDITS AND RESEARCH NOL’S MUST BE USED  
5 EXCLUSIVELY FOR RESEARCH OR EXPERIMENTATION  
6 PURPOSES; RECAPTURE.—

7 “(1) RECAPTURE OF CREDIT IN THE EVENT OF  
8 FAILURE TO INCREASE RESEARCH AND EXPERIMEN-  
9 TATION ACTIVITY.—If—

10 “(A) the sum of—

11 “(i) the credit received by a qualified  
12 research corporation from an election  
13 under this section made on its tax return  
14 for a taxable year (the election year), plus

15 “(ii) the amount of its research or ex-  
16 perimental expenditures (within the mean-  
17 ing of section 174, but prior to application  
18 of section 280C) paid or incurred during  
19 the election year, exceeds

20 “(B) the amount of such research or ex-  
21 perimental expenditures paid or incurred by the  
22 qualified research corporation during the tax-  
23 able year immediately following the election  
24 year,

1 then the election shall be void to the extent of the  
2 excess, and the excess shall be treated as an under-  
3 payment of tax imposed by this chapter for the elec-  
4 tion year without regard to any credit otherwise al-  
5 lowable under this chapter.

6 “(2) UNDERPAYMENT NOT SUBJECT TO CER-  
7 TAIN PENALTIES.—An underpayment of tax deter-  
8 mined under paragraph (1) shall not be taken into  
9 account in determining any penalties or additions to  
10 tax under sections 6655 and 6662.

11 “(3) RECAPTURE PENALTY LIMITED TO THE  
12 AMOUNT OF EXCHANGE ELECTION PAYMENTS RE-  
13 CEIVED.—An underpayment of tax determined  
14 under paragraph (1) shall not exceed the amount  
15 taken into account under paragraph (1)(A)(i).

16 “(4) EXCEPTION.—No increase in the aggre-  
17 gate amounts paid by a qualified research corpora-  
18 tion to a person with whom the corporation has a re-  
19 lationship specified in section 267(b) shall be taken  
20 into account in determining the amount of any ex-  
21 cess under paragraph (1).

22 “(h) ADDITIONAL REQUIREMENTS FOR A QUALIFIED  
23 RESEARCH CORPORATION.—

24 “(1) IN GENERAL.—A corporation shall be con-  
25 sidered as meeting the requirements of this sub-

1 section for any taxable year if during such taxable  
2 year—

3 “(A) at least 80 percent (by value) of the  
4 assets of such corporation are used by such cor-  
5 poration in the active conduct of 1 or more  
6 qualified trades or businesses,

7 “(B) such corporation is an eligible cor-  
8 poration, and

9 “(C) such corporation has aggregate gross  
10 assets (as defined in section 1202(d)(2)) of not  
11 more than \$500,000,000.

12 “(2) SPECIAL RULE FOR CERTAIN ACTIVI-  
13 TIES.—For purposes of paragraph (1), if, in connec-  
14 tion with any future qualified trade or business, a  
15 corporation is engaged in—

16 “(A) startup activities described in section  
17 195(c)(1)(A),

18 “(B) activities resulting in the payment or  
19 incurring of expenditures which may be treated  
20 as research and experimental expenditures  
21 under section 174, or

22 “(C) activities with respect to in-house re-  
23 search expenses described in section 41(b)(4),  
24 assets used in such activities shall be treated as used  
25 in the active conduct of a qualified trade or busi-

1       ness. Any determination under this paragraph shall  
2       be made without regard to whether a corporation  
3       has any gross income from such activities at the  
4       time of the determination.

5           “(3) QUALIFIED TRADE OR BUSINESS.—For  
6       purposes of this subsection, the term ‘qualified trade  
7       or business’ means any trade or business other  
8       than—

9           “(A) any trade or business involving the  
10       performance of services in the fields of health,  
11       law, engineering, architecture, accounting, actu-  
12       arial science, performing arts, consulting, ath-  
13       letics, financial services, brokerage services, or  
14       any trade or business where the principal asset  
15       of such trade or business is the reputation or  
16       skill of 1 or more of its employees,

17           “(B) any banking, insurance, financing,  
18       leasing, investing, or similar business,

19           “(C) any farming business (including the  
20       business of raising or harvesting trees),

21           “(D) any business involving the production  
22       or extraction of products of a character with re-  
23       spect to which a deduction is allowable under  
24       section 613 or 613A, and

1           “(E) any business of operating a hotel,  
2           motel, restaurant, or similar business.

3           “(4) ELIGIBLE CORPORATION.—For purposes  
4           of this subsection, the term ‘eligible corporation’  
5           means any domestic corporation, except that such  
6           term shall not include—

7                   “(A) a DISC or former DISC,

8                   “(B) a corporation with respect to which  
9                   an election under section 936 is in effect or  
10                  which has a direct or indirect subsidiary with  
11                  respect to which such an election is in effect,

12                  “(C) a FSC (as defined in section 922, as  
13                  in effect on the day before the date of the en-  
14                  actment of the FSC Repeal and Extraterritorial  
15                  Income Exclusion Act of 2000),

16                  “(D) a regulated investment company, real  
17                  estate investment trust, REMIC, or FASIT, or

18                  “(E) a cooperative.

19           “(5) STOCK IN OTHER CORPORATIONS.—

20                   “(A) LOOK-THRU IN CASE OF SUBSIDI-  
21                   ARIES.—For purposes of this subsection, stock  
22                   and debt in any subsidiary corporation shall be  
23                   disregarded and the parent corporation shall be  
24                   deemed to own its ratable share of the subsidi-

1           ary’s assets, and to conduct its ratable share of  
2           the subsidiary’s activities.

3           “(B) PORTFOLIO STOCK OR SECURITIES.—  
4           A corporation shall be treated as failing to meet  
5           the requirements of paragraph (1) for any pe-  
6           riod during which more than 10 percent of the  
7           value of its assets (in excess of liabilities) con-  
8           sist of stock or securities in other corporations  
9           which are not subsidiaries of such corporation  
10          (other than assets described in paragraph (7)).

11          “(C) SUBSIDIARY.—For purposes of this  
12          paragraph, a corporation shall be considered a  
13          subsidiary if the parent owns more than 50 per-  
14          cent of the combined voting power of all classes  
15          of stock entitled to vote, or more than 50 per-  
16          cent in value of all outstanding stock, of such  
17          corporation.

18          “(6) WORKING CAPITAL.—For purposes of  
19          paragraph (2)(A), any assets which—

20                 “(A) are held as a part of the reasonably  
21                 required working capital needs of a qualified  
22                 trade or business of the corporation, or

23                 “(B) are held for investment and are rea-  
24                 sonably expected to be used within 5 years to  
25                 finance research and experimentation in a

1 qualified trade or business or increases in work-  
2 ing capital needs of a qualified trade or busi-  
3 ness,

4 shall be treated as used in the active conduct of a  
5 qualified trade or business. For periods after the  
6 corporation has been in existence for at least 5  
7 years, in no event may more than 50 percent of the  
8 assets of the corporation qualify as used in the ac-  
9 tive conduct of a qualified trade or business by rea-  
10 son of this paragraph.

11 “(7) MAXIMUM REAL ESTATE HOLDINGS.—A  
12 corporation shall not be treated as meeting the re-  
13 quirements of paragraph (2) for any period during  
14 which more than 10 percent of the total value of its  
15 assets consists of real property which is not used in  
16 the active conduct of a qualified trade or business.  
17 For purposes of the preceding sentence, the owner-  
18 ship of, dealing in, or renting of real property shall  
19 not be treated as the active conduct of a qualified  
20 trade or business.

21 “(8) COMPUTER SOFTWARE ROYALTIES.—For  
22 purposes of paragraph (2), rights to computer soft-  
23 ware which produces active business computer soft-  
24 ware royalties (within the meaning of section

1       543(d)(1)) shall be treated as an asset used in the  
2       active conduct of a trade or business.

3       “(i) REGULATIONS.—The Secretary may prescribe  
4       such regulations as may be necessary to carry out the pur-  
5       poses of this section, including regulations coordinating  
6       the application of this section with the consolidated return  
7       regulations and regulations providing for the application  
8       of this section to short taxable years.”.

9       (b) CONFORMING AMENDMENTS.—

10           (1) Section 55(c)(1) of the Internal Revenue  
11       Code of 1986 is amended by striking “section  
12       49(b)” and inserting “section 35(g), 49(b),”.

13           (2) Section 1324(b)(2) of title 31, United  
14       States Code, is amended by striking “or” before  
15       “enacted” and by inserting before the period at the  
16       end “, or from section 35 of such Code”.

17       (c) CLERICAL AMENDMENT.—The table of sections  
18       for subpart C of part IV of subchapter A of chapter 1  
19       of the Internal Revenue Code of 1986 is amended by strik-  
20       ing the item relating to section 35 and inserting the fol-  
21       lowing new items:

“Sec. 35. Breakthrough research credit.

“Sec. 36. Overpayments of tax.”.

1           (d) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to taxable years beginning after  
3 December 31, 2001.

○