

107TH CONGRESS
1ST SESSION

S. 1049

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.

IN THE SENATE OF THE UNITED STATES

JUNE 14, 2001

Mr. TORRICELLI introduced the following bill; which was read twice and referred to the Committee on Finance

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 programs be encour-
7 aged.

8 (2) Such long-term research and development
9 programs have the greatest potential to revolutionize
10 whole fields of science and industry for the benefit
11 of the standard of living of Americans and to yield
12 solutions for critical social needs, even though these
13 solutions might not result in large sales and profits
14 (such as “orphan” drugs and other treatments alle-
15 viating great 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 and
22 development, these companies must often seek to en-
23 dure without products and little or no earnings.
24 Many are small businesses lacking the resources and
25 stability of large corporations.

1 (5) In addition to the scientific and technical
2 risks attending their long-term breakthrough re-
3 search and development programs, many high tech-
4 nology companies must subject their technologies
5 through lengthy and expensive regulatory reviews be-
6 fore such technologies are permitted access to the
7 marketplace.

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

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

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

23 (9) These high technology companies typically
24 incur net operating losses during their lengthy re-
25 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 such companies at a sub-
14 stantial disadvantage in the capital marketplace
15 where they must compete for capital with other com-
16 panies able 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 development have the same cost-reducing
20 impact on companies conducting both short-term
21 and long-term research and thus render this tax in-
22 centive program neutral with regard to short-term
23 and long-term research objectives and minimize mar-
24 ketplace distortions caused by differences in tax and
25 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.—Subpart C of part IV of sub-
15 chapter A of chapter 1 of the Internal Revenue Code of
16 1986 (relating to refundable credits) is amended by redес-
17 ignating section 35 as section 36 and by inserting after
18 section 34 the following new section:

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

20 “(a) GENERAL RULE.—In the case of a qualified re-
21 search corporation, there shall be allowed as a credit
22 against the tax imposed by this subtitle for the taxable
23 year an amount equal to the sum of the discounted re-
24 search credits and discounted research NOL’s subject to

1 an election in such taxable year by the taxpayer under sub-
2 section (d).

3 “(b) QUALIFIED RESEARCH CORPORATION.—For the
4 purposes of this section, the term ‘qualified research cor-
5 poration’ means any domestic corporation subject to tax
6 under subchapter C of this chapter—

7 “(1) which has not incurred regular tax liability
8 (as defined in section 55(c)) under this chapter for
9 a period of at least 3 consecutive taxable years
10 (other than short taxable years) preceding the tax-
11 able year in which an election is made under sub-
12 section (d),

13 “(2) which has not been controlled by, or been
14 under common control (as determined under section
15 267(b)) with, a corporation which has incurred reg-
16 ular tax liability (as so defined) under this chapter
17 for any taxable year beginning during the period de-
18 scribed in paragraph (1),

19 “(3) at all times during the period described in
20 paragraph (1) has met the requirements of sub-
21 section (h), and

22 “(4) which is not the subject of any proceeding
23 under Federal or State bankruptcy or insolvency
24 laws.

1 “(c) DEFINITIONS.—For the purposes of this
2 section—

3 “(1) RESEARCH CREDIT.—The term ‘research
4 credit’ means the sum of those portions of a quali-
5 fied research corporation’s current year business
6 credit and business credit carryforwards, as deter-
7 mined under section 38(a) for the taxable year,
8 which are attributable to the credit determined
9 under section 41 (for increases in research activities)
10 and to the orphan drug credit determined under sec-
11 tion 45C (for clinical testing expenses for certain
12 drugs for rare diseases or conditions).

13 “(2) RESEARCH NOL.—The term ‘research
14 NOL’ means that portion of a qualified research cor-
15 poration’s net operating loss (as defined in section
16 172(c)) for the taxable year attributable to qualified
17 research expenses (as defined in section 41(b)), basic
18 research expenses (as defined in section 41(e)(2)),
19 and qualified clinical testing expenses (as defined in
20 section 45C(b)) allowed as deductions for research
21 or experimentation activities under section 174
22 (after the application of section 280C) for such tax-
23 able year.

24 “(3) DISCOUNTED RESEARCH CREDIT.—The
25 term ‘discounted research credit’ means 75 percent

1 of the amount of a qualified research corporation's
2 research credit for the taxable year subject to an
3 election under subsection (d).

4 “(4) DISCOUNTED RESEARCH NOL.—The term
5 ‘discounted research NOL’ means 75 percent of the
6 amount of a qualified research corporation’s re-
7 search NOL for the taxable year subject to an elec-
8 tion under subsection (d), multiplied by the highest
9 marginal tax rate in effect under section 11 for such
10 taxable year.

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

19 “(6) ALLOWABLE EXPENDITURES.—For pur-
20 poses of determining a qualified research corpora-
21 tion’s research credit or research NOL, no expendi-
22 ture for which such corporation is reimbursed by an-
23 other taxpayer shall be taken into account, except to
24 the extent that the reimbursing taxpayer provides a

1 certification to the qualified research corporation
2 that—

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

6 “(B) the reimbursing taxpayer shall not
7 take such expenditures into account in claiming
8 any credits under this chapter.

9 “(d) ELECTION TO RELINQUISH RESEARCH-RE-
10 LATED TAX CREDITS AND NET OPERATING LOSSES FOR
11 REFUNDABLE CREDIT.—

12 “(1) GENERAL RULE; BENEFITS ARISING IN
13 CURRENT YEAR.—A qualified research corporation
14 may make an election under this subsection to relin-
15 quish all of its research credits and research NOL’s
16 for the taxable year for the credit under subsection
17 (a). The corporation shall make the election on its
18 timely filed tax return (including extensions) for the
19 taxable year in which the research credits and re-
20 search NOL’s arise.

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

23 “(A) IN GENERAL.—The election under
24 this subsection for any taxable year may include
25 any research credits or research NOL’s not

1 subject to an election under this subsection in
2 any preceding taxable year, which arose in such
3 preceding taxable year and with respect to
4 which the qualified research corporation is enti-
5 tled to carry forward to the taxable year of the
6 election.

7 “(B) LIMITATION.—For any taxable year,
8 the sum of research credit carryforwards and
9 research NOL carryforwards to the taxable year
10 which may be designated as covered by an elec-
11 tion under this subsection shall not exceed the
12 greater of—

13 “(i) the average of the annual
14 amounts of the qualified research corpora-
15 tion’s research credits and research NOL’s
16 arising in the 3-taxable year period ending
17 immediately before the taxable year of the
18 election, or

19 “(ii) 20 percent of the qualified re-
20 search corporation’s research credit
21 carryforwards and research NOL
22 carryforwards.

23 “(3) PROCEDURES AND RECORDKEEPING BY
24 ELECTING CORPORATION.—An election under this
25 subsection may be revoked by the taxpayer only with

1 the consent of the Secretary. Any qualified research
2 corporation making such an election shall provide
3 such information in connection with such election as
4 may be required by the Secretary and shall maintain
5 records sufficient to permit the Secretary to identify
6 and to audit the specific research credits and re-
7 search NOL's that are subject to an election under
8 this subsection.

9 “(e) EXTINGUISHMENT OF RELINQUISHED TAX
10 BENEFITS.—

11 “(1) CREDITS.—No credit shall be allowed for
12 any taxable year to a qualified research corporation
13 under section 38(a) with respect to any research
14 credit determined under section 41 or 45C for which
15 an election under subsection (d) is in effect.

16 “(2) DEDUCTIONS.—No deduction shall be al-
17 lowed for any taxable year to a qualified research
18 corporation under the alternative minimum tax pro-
19 visions of section 56(a)(4) or the net operating loss
20 provisions of section 172 with respect to any re-
21 search NOL for which an election under subsection
22 (d) is in effect.

23 “(f) LIMITATION ON USE OF NONRELINQUISHED
24 TAX BENEFITS BY ELECTING CORPORATION.—A quali-
25 fied research corporation which has claimed a credit under

1 subsection (a) pursuant to an election under subsection
 2 (d) shall not be entitled to utilize any carrybacks or
 3 carryforwards of research credits or research NOL's
 4 (which are not subject to an election under subsection (d)
 5 and are otherwise available to be utilized in the taxable
 6 year) to reduce taxable income or to offset any tax liability
 7 for any taxable year after the year of such election, until
 8 such corporation has paid tax imposed under this chapter
 9 for all such taxable years in an aggregate amount equal
 10 to the aggregate amount of the credits allowed under sub-
 11 section (a) for any preceding taxable year, less any under-
 12 payment amount determined under subsection (g).

13 “(g) CREDIT PROCEEDS FROM EXCHANGE OF RE-
 14 SEARCH CREDITS AND RESEARCH NOL'S MUST BE USED
 15 EXCLUSIVELY FOR RESEARCH OR EXPERIMENTATION
 16 PURPOSES; RECAPTURE.—

17 “(1) RECAPTURE OF CREDIT IN THE EVENT OF
 18 FAILURE TO INCREASE RESEARCH AND EXPERIMEN-
 19 TATION ACTIVITY.—If—

20 “(A) the sum of—

21 “(i) the credit allowed under sub-
 22 section (a) to a qualified research corpora-
 23 tion pursuant to an election under sub-
 24 section (d) for any taxable year, plus

1 “(ii) the amount of such corporation’s
2 research or experimental expenditures
3 (within the meaning of section 174, as
4 modified by subsection (c)(2), but prior to
5 application of section 280C) paid or in-
6 curred during such taxable year, exceeds

7 “(B) the amount of such research or ex-
8 perimental expenditures paid or incurred by the
9 qualified research corporation during the imme-
10 diately succeeding taxable year,

11 then the election under subsection (d) shall be void
12 to the extent of the excess, and the excess shall be
13 treated as an underpayment of tax imposed by this
14 chapter for the taxable year of such election without
15 regard to any credit otherwise allowable under this
16 chapter.

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

22 “(3) RECAPTURE PENALTY LIMITED TO THE
23 AMOUNT OF EXCHANGE ELECTION PAYMENTS RE-
24 CEIVED.—An underpayment of tax determined

1 under paragraph (1) shall not exceed the amount
2 taken into account under paragraph (1)(A)(i).

3 “(4) EXCEPTION.—No increase in the aggregate
4 amounts paid by a qualified research corporation
5 to a person with whom the corporation has a relationship
6 specified in section 267(b) shall be taken
7 into account in determining the amount of any excess
8 under paragraph (1).

9 “(h) ADDITIONAL REQUIREMENTS FOR A QUALIFIED
10 RESEARCH CORPORATION.—

11 “(1) IN GENERAL.—A corporation shall be considered
12 as meeting the requirements of this subsection
13 for any taxable year if during such taxable
14 year—

15 “(A) at least 80 percent (by value) of the
16 assets of such corporation are used by such corporation
17 in the active conduct of 1 or more
18 qualified trades or businesses,

19 “(B) such corporation is an eligible corporation,
20 and

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

24 “(2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes
25 of paragraph (1), if, in connection with the

1 tion with any future qualified trade or business, a
2 corporation is engaged in—

3 “(A) startup activities described in section
4 195(c)(1)(A),

5 “(B) activities resulting in the payment or
6 incurring of expenditures which may be treated
7 as research and experimental expenditures
8 under section 174, or

9 “(C) activities with respect to in-house re-
10 search expenses described in section 41(b)(4),
11 assets used in such activities shall be treated as used
12 in the active conduct of a qualified trade or busi-
13 ness. Any determination under this paragraph shall
14 be made without regard to whether a corporation
15 has any gross income from such activities at the
16 time of the determination.

17 “(3) QUALIFIED TRADE OR BUSINESS.—For
18 purposes of this subsection, the term ‘qualified trade
19 or business’ means any trade or business other
20 than—

21 “(A) any trade or business involving the
22 performance of services in the fields of health,
23 law, engineering, architecture, accounting, actu-
24 arial science, performing arts, consulting, ath-
25 letics, financial services, brokerage services, or

1 any trade or business where the principal asset
2 of such trade or business is the reputation or
3 skill of 1 or more of its employees,

4 “(B) any banking, insurance, financing,
5 leasing, investing, or similar business,

6 “(C) any farming business (including the
7 business of raising or harvesting trees),

8 “(D) any business involving the production
9 or extraction of products of a character with re-
10 spect to which a deduction is allowable under
11 section 613 or 613A, and

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

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

18 “(A) a DISC or former DISC,

19 “(B) a corporation with respect to which
20 an election under section 936 is in effect or
21 which has a direct or indirect subsidiary with
22 respect to which such an election is in effect,

23 “(C) a regulated investment company, real
24 estate investment trust, REMIC, or FASIT, or

25 “(D) a cooperative.

1 “(5) STOCK IN OTHER CORPORATIONS.—

2 “(A) LOOK-THRU IN CASE OF SUBSIDI-
3 ARIES.—For purposes of this subsection, stock
4 and debt in any subsidiary corporation shall be
5 disregarded and the parent corporation shall be
6 deemed to own its ratable share of the subsidi-
7 ary’s assets, and to conduct its ratable share of
8 the subsidiary’s activities.

9 “(B) PORTFOLIO STOCK OR SECURITIES.—

10 A corporation shall be treated as failing to meet
11 the requirements of paragraph (1) for any pe-
12 riod during which more than 10 percent of the
13 value of its assets (in excess of liabilities) con-
14 sist of stock or securities in other corporations
15 which are not subsidiaries of such corporation
16 (other than assets described in paragraph (7)).

17 “(C) SUBSIDIARY.—For purposes of this
18 paragraph, a corporation shall be considered a
19 subsidiary if the parent owns more than 50 per-
20 cent of the combined voting power of all classes
21 of stock entitled to vote, or more than 50 per-
22 cent in value of all outstanding stock, of such
23 corporation.

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

1 “(A) are held as a part of the reasonably
2 required working capital needs of a qualified
3 trade or business of the corporation, or

4 “(B) are held for investment and are rea-
5 sonably expected to be used within 5 taxable
6 years to finance research and experimentation
7 in a qualified trade or business or increases in
8 working capital needs of a qualified trade or
9 business,

10 shall be treated as used in the active conduct of a
11 qualified trade or business. For periods after the
12 corporation has been in existence for at least 5 tax-
13 able years, in no event may more than 50 percent
14 of the assets of the corporation qualify as used in
15 the active conduct of a qualified trade or business by
16 reason of this paragraph.

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

1 not be treated as the active conduct of a qualified
2 trade or business.

3 “(8) COMPUTER SOFTWARE ROYALTIES.—For
4 purposes of paragraph (2), rights to computer soft-
5 ware which produces active business computer soft-
6 ware royalties (within the meaning of section
7 543(d)(1)) shall be treated as an asset used in the
8 active conduct of a trade or business.

9 “(i) REGULATIONS.—The Secretary shall prescribe
10 such regulations as may be necessary to carry out the pur-
11 poses of this section, including regulations coordinating
12 the application of this section with the consolidated return
13 regulations and regulations providing for the application
14 of this section to short taxable years.”.

15 (b) CONFORMING AMENDMENTS.—

16 (1) Section 55(c)(1) of the Internal Revenue
17 Code of 1986 is amended by striking “section
18 49(b)” and inserting “section 35(g), 49(b),”.

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

23 (c) CLERICAL AMENDMENT.—The table of sections
24 for subpart C of part IV of subchapter A of chapter 1
25 of the Internal Revenue Code of 1986 is amended by strik-

1 ing the item relating to section 35 and inserting the fol-
2 lowing new items:

“Sec. 35. Breakthrough research credit.

“Sec. 36. Overpayments of tax.”.

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

○