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Memorandum

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to: Barbara M. Leonard
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(Communications, Technology, & Media)

from: William P. O'Shea
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subject: Section 280C(c)(3) - Guidance on Reduced Credit for Increasing Research Activities

This memorandum should not be used or cited as precedent. This memorandum discusses certain situations in which taxpayers purport to elect the reduced credit under § 280C(c)(3) of the Internal Revenue Code for the § 41 credit for increasing research activities ("research credit") and constitutes generic legal advice in accordance with Chief Counsel Notice CC-2007-003, Non-Taxpayer Specific Legal Advice (January 17, 2007).

ISSUES

ISSUE 1

Has a taxpayer made a valid reduced credit election under § 280C(c)(3) if it clearly indicates its intent to claim the credit on its timely filed original return for the taxable year, even if it does not provide the amount of the reduced credit with its return, for example, by noting "section 280C" next to the line on which the current year reduced credit could be claimed on Form 6765, "Credit for Increasing Research Activities," or by claiming a nominal credit amount along with the "section 280C" notation?

ISSUE 2

Does a taxpayer make a valid reduced credit election under § 280C(c)(3) by indicating on its timely filed original return for the taxable year or on an attached statement that it is reserving or otherwise deferring its decision to elect the § 280C(c)(3) reduced credit?

CONCLUSIONS

ISSUE 1

A taxpayer should be treated as having made a valid reduced credit election under § 280C(c)(3) if it clearly indicates its intent to claim the reduced credit on its timely filed original return for the taxable year.

ISSUE 2

A taxpayer should not be treated as having made a valid reduced credit election under § 280C(c)(3) if it indicates on a timely filed original return for the taxable year that it has reserved or otherwise deferred the election under § 280C(c)(3).

ISSUE 1

FACTS

A taxpayer is a corporation that incurred research expenditures eligible for the research credit during years 2001 through 2004. The taxpayer did not claim the research credit on its original income tax returns for those years. On its Forms 1120, the taxpayer included Forms 6765, which were blank except for a notation stating "section 280C" next to the line on which the current year reduced credit could be claimed, or claimed a nominal credit amount (for example, \$1) along with the "section 280C" notation.

LAW AND ANALYSIS

Section 280C(c)(1) provides that no deduction shall be allowed for that portion of the qualified research expenses or basic research expenses (as defined in § 41(b)) or basic research expenses (as defined in § 41(e)(2)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for such taxable year under § 41(a).

Section 280C(c)(3)(A) provides that in the case of any taxable year for which an election is made under § 280C(c)(3), § 280C(c)(1) and (2) shall not apply, and the amount of the credit under § 41(a) shall be the amount determined under § 280C(c)(3)(B). The amount of the credit under § 280C(c)(3)(B) for any taxable year is the amount equal to the excess of the amount of credit determined under § 41(a) without regard to § 280C(c)(3), over the product of the amount of credit determined under § 41(a) without regard to § 280C(c)(3), and the maximum rate of tax under § 11(b)(1).

Under § 280C(c)(3)(C), the election shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on the return, and shall be made in such manner as the Secretary may prescribe. Once made, the election is irrevocable.

Section 1.280C-4(a) of the Income Tax Regulations provides that the election under § 280C(c)(3) to have the provisions of § 280C(c)(1) and (2) not apply shall be made by claiming the reduced credit under § 41(a) determined by the method provided in § 280C(c)(3)(B) on an original return for the taxable year, filed at any time on or before the due date (including extensions) for filing the income tax return for such year.

A taxpayer that clearly indicates its intent to claim the reduced credit by noting on the Form 6765 attached to its timely filed an original return for the taxable year “section 280C” next to the line on which the current year reduced credit could be claimed or by claiming a nominal credit amount along with the “section 280C” notation has satisfied the requirements under §§ 280C(c)(3) and 1.280C-4(a). Such notations clearly signify that the taxpayer has made an affirmative election to claim the reduced credit.¹ Once made, the election is irrevocable and, thus, a taxpayer may not subsequently take an inconsistent position on a later filed return. In the situation where no credit amount or a nominal credit amount is claimed, the taxpayer must calculate the reduced credit amount under § 41(a) determined by the method provided in § 280C(c)(3)(B) on its timely filed amended tax return or other claim for refund.

ISSUE 2

FACTS

A taxpayer is a corporation that incurred research expenditures eligible for the § 41 research credit during years 2001 through 2004. The taxpayer did not claim the research credit on its income tax returns for those years. On the Forms 1120, the taxpayer attached written statements reserving the right to elect the § 280C(c)(3) reduced credit on a future amended return.

LAW AND ANALYSIS

Sections 280C(c)(3)(C) and 1.280C-4(a) require that the taxpayer make the § 280C(c)(3) reduced credit election on its original return for the taxable year. By attaching a statement to reserve reduced credit election, the taxpayer has attempted to reserve or otherwise defer its decision whether or not to make the election until after it has filed its original return. As a result, the taxpayer has failed to make a valid election.

¹ For tax years beginning in 2006, a taxpayer signifies on Form 6765 its intent to elect the reduced credit by checking the box “Yes” on the line that asks, “Are you electing the reduced credit under § 280C?”

These facts are distinguishable from cases in which protective elections have been allowed. For example, in H. Fort Flowers Foundation, Inc. v. Commissioner of Internal Revenue, 72 T.C. 399 (1979), the Tax Court allowed the taxpayer to make a protective election involving § 4942, requiring private foundations to make certain minimum levels of charitable contributions. Under § 4942, if a private foundation does not make the required minimum distribution in one taxable year but has distributions from another taxable year that were not included as part of the distribution for such taxable year, the foundation may elect to treat the excess distribution as being made from the funds of the taxable year in which the minimum requirement was not met. The taxpayer in H. Fort Flowers Foundation, Inc. made a protective election stating that, if it was determined that the minimum distribution level was not met in one taxable year, it would then elect to treat the distribution from a later year as being made from the funds of the deficient year. The court ruled that “[p]etitioner should not be forced to make an absolute election to correct a possible but not certain under distribution in an earlier year until that under distribution has been established.” H. Fort Flowers Foundation, Inc., 72 T.C. at 410.

In Estate of Mapes v. Commissioner, 99 T.C. 511 (1992), the Tax Court considered whether the petitioner made a protective election under § 2032, involving alternate valuation of an estate. The petitioner attempted to elect special use valuation treatment of farm property under § 2032A. In the event that the estate did not qualify for this treatment, the petitioner filed a protective election under § 2032 for alternate valuation of the estate. The court held that, although § 2032 did not explicitly allow for protective elections, the petitioner was entitled to make this protective election. In so holding, the court looked at several factors. Of relevance in this case, the court noted that the companion provision to § 2032, namely § 2032A, and the related provision of § 6166 both explicitly allow taxpayers to file protective elections. In addition, the petitioner’s election was again subject to a contingency outside the petitioner’s control, *i.e.* whether the Service would allow the special use valuation of farm property under § 2032A.

Unlike the petitioners in H. Fort Flowers Foundation, Inc. and Estate of Mapes, the taxpayer’s right to claim the reduced credit is not subject to a contingency. Whereas in those cases the determinations of under distribution and unavailability of special use valuation were outside of the petitioners’ control, the taxpayer under these facts is entitled to claim the reduced credit under § 280C(c)(3), and it is only the credit computation that is in question.

Please call me at (202) 622-3000 or David Selig at (202) 622-3040 if you have any further questions about this matter.

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