

Internal Revenue Code Section 41

Credit for increasing research activities

(a) General rule.

For purposes of section 38 , the research credit determined under this section for the taxable year shall be an amount equal to the sum of-

(1)

20 percent of the excess (if any) of-

(A) the qualified research expenses for the taxable year, over

(B) the base amount,

(2)

20 percent of the basic research payments determined under subsection (e)(1)(A) , and

(3)

20 percent of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

(b) Qualified research expenses.

For purposes of this section -

(1) Qualified research expenses.

The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer-

(A) in-house research expenses, and

(B) contract research expenses.

(2) In-house research expenses.

(A) In general. The term "in-house research expenses" means-

(i) any wages paid or incurred to an employee for qualified services performed by such employee,

(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and

(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

Clause (iii) shall not apply to any amount to the extent that the taxpayer (or any person with whom the taxpayer must aggregate expenditures under subsection (f)(1)) receives or accrues any amount from any other person for the right to use substantially identical personal property.

(B) Qualified services. The term "qualified services" means services consisting of-

(i) engaging in qualified research, or

(ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

If substantially all of the services performed by an individual for the taxpayer during the taxable year consists of services meeting the requirements of clause (i) or (ii) , the term "qualified services" means all of the services performed by such individual for the taxpayer during the taxable year.

(C) Supplies. The term "supplies" means any tangible property other than-

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(D) Wages.

(i) In general. The term "wages" has the meaning given such term by section 3401(a) .

(ii) Self-employed individuals and owner-employees. In the case of an employee (within the meaning of section 401(c)(1)), the term "wages" includes the earned income (as defined in section 401(c)(2)) of such employee.

(iii) Exclusion for wages to which work opportunity credit applies. The term "wages" shall not include any amount taken into account in determining the work opportunity credit under section 51(a) .

(3) Contract research expenses.

(A) In general. The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) Prepaid amounts. If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

(C) Amounts paid to certain research consortia.

(i) In general. Subparagraph (A) shall be applied by substituting "75 percent" for "65 percent" with respect to amounts paid or incurred by the taxpayer to a qualified research consortium for qualified research on behalf of the taxpayer and 1 or more unrelated taxpayers. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related taxpayers.

(ii) Qualified research consortium. The term "qualified research consortium" means any organization which-

(I) is described in section 501(c)(3) or 501(c)(6) and is exempt from tax under section 501(a) ,

(II) is organized and operated primarily to conduct scientific research, and

(III) is not a private foundation.

(D) Amounts paid to eligible small businesses, universities, and Federal laboratories.

(i) In general. In the case of amounts paid by the taxpayer to-

(I) an eligible small business,

(II) an institution of higher education (as defined in section 3304(f)), or

(III) an organization which is a Federal laboratory,

for qualified research which is energy research, subparagraph (A) shall be applied by substituting "100 percent" for "65 percent".

(ii) Eligible small business. For purposes of this subparagraph , the term "eligible small business" means a small business with respect to which the taxpayer does not own (within the meaning of section 318) 50 percent or more of-

(I) in the case of a corporation, the outstanding stock of the corporation (either by vote or value), and

(II) in the case of a small business which is not a corporation, the capital and profits interests of the small business.

(iii) Small business. For purposes of this subparagraph -

(I) In general. The term "small business" means, with respect to any calendar year, any person if the annual average number of employees employed by such person during either of the 2 preceding calendar years was 500 or fewer. For purposes of the preceding sentence, a preceding calendar year may be taken into account only if the person was in existence throughout the year.

(II) Startups, controlled groups, and predecessors. Rules similar to the rules of subparagraphs (B) and (D) of section 220(c)(4) shall apply for purposes of this clause.

(iv) Federal laboratory. For purposes of this subparagraph, the term "Federal laboratory" has the meaning given such term by section 4(6) of the Stevenson-Wydler Technology Innovation Act of 1980 (15 U.S.C. 3703(6)), as in effect on the date of the enactment of the Energy Tax Incentives Act of 2005.

(4) Trade or business requirement disregarded for in-house research expenses of certain startup ventures.

In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business-

(A) of the taxpayer, or

(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1).

(c) Base amount.

(1) In general.

The term "base amount" means the product of-

(A) the fixed-base percentage, and

(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the "credit year").

(2) Minimum base amount.

In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

(3) Fixed-base percentage.

(A) In general. Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, is of the aggregate gross receipts of the taxpayer for such taxable years.

(B) Start-up companies.

(i) Taxpayers to which subparagraph applies. The fixed-base percentage shall be determined under this subparagraph if-

(I) the first taxable year in which a taxpayer had both gross receipts and qualified research expenses begins after December 31, 1983, or

(II) there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

(ii) Fixed-base percentage. In a case to which this subparagraph applies, the fixed-base percentage is-

(I) 3 percent for each of the taxpayer's 1st 5 taxable years beginning after December 31, 1993, for which the taxpayer has qualified research expenses,

(II) in the case of the taxpayer's 6th such taxable year, $\frac{1}{6}$ of the percentage which the aggregate qualified research expenses of the taxpayer for the 4th and 5th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(III) in the case of the taxpayer's 7th such taxable year, $\frac{1}{3}$ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th and 6th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(IV) in the case of the taxpayer's 8th such taxable year, $\frac{1}{2}$ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, and 7th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(V) in the case of the taxpayer's 9th such taxable year, $\frac{2}{3}$ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, and 8th such taxable years is of the aggregate gross receipts of the taxpayer for such years,

(VI) in the case of the taxpayer's 10th such taxable year, $\frac{5}{6}$ of the percentage which the aggregate qualified research expenses of the taxpayer for the 5th, 6th, 7th, 8th, and 9th such taxable years is of the aggregate gross receipts of the taxpayer for such years, and

(VII) for taxable years thereafter, the percentage which the aggregate qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through the 10th such taxable years is of the aggregate gross receipts of the taxpayer for such selected years.

(iii) Treatment of de minimis amounts of gross receipts and qualified research expenses. The Secretary may prescribe regulations providing that de minimis amounts of gross receipts and qualified research expenses shall be disregarded under clauses (i) and (ii) .

(C) Maximum fixed-base percentage. In no event shall the fixed-base percentage exceed 16 percent.

(D) Rounding. The percentages determined under subparagraphs (A) and (B)(ii) shall be rounded to the nearest 1/100th of 1 percent.

(4) Election of alternative incremental credit.

(A) In general. At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to the sum of-

(i) 3 percent of so much of the qualified research expenses for the taxable year as exceeds 1 percent of the average described in subsection (c)(1)(B) but does not exceed 1.5 percent of such average,

(ii) 4 percent of so much of such expenses as exceeds 1.5 percent of such average but does not exceed 2 percent of such average, and

(iii) 5 percent of so much of such expenses as exceeds 2 percent of such average.

(B) Election. An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.

(5) Election of alternative simplified credit.

(A) In general. At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to 14 percent (12 percent in the case of taxable years ending before January 1, 2009) of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

(B) Special rule in case of no qualified research expenses in any of 3 preceding taxable years.

(i) Taxpayers to which subparagraph applies. The credit under this paragraph shall be determined under this subparagraph if the taxpayer has no qualified research expenses in any one of the 3 taxable years preceding the taxable year for which the credit is being determined.

(ii) Credit rate. The credit determined under this subparagraph shall be equal to 6 percent of the qualified research expenses for the taxable year.

(C) Election. An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary. An election under this paragraph may not be made for any taxable year to which an election under paragraph (4) applies.

(6) Consistent treatment of expenses required.

(A) In general. Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

(B) Prevention of distortions. The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

(7) Gross receipts.

For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(d) Qualified research defined.

For purposes of this section -

(1) In general.

The term "qualified research" means research-

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information-

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

(2) Tests to be applied separately to each business component.

For purposes of this subsection -

(A) In general. Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

(B) Business component defined. The term "business component" means any product, process, computer software, technique, formula, or invention which is to be-

(i) held for sale, lease, or license, or

the taxpayer in a trade or business of the taxpayer.

(C) Special rule for production processes. Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

(3) Purposes for which research may qualify for credit.

For purposes of paragraph (1)(C) -

(A) In general. Research shall be treated as conducted for a purpose described in this paragraph if it relates to-

(i) a new or improved function,

(ii) performance, or

(iii) reliability or quality.

(B) Certain purposes not qualified. Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

(4) Activities for which credit not allowed.

The term "qualified research" shall not include any of the following:

(A) Research after commercial production. Any research conducted after the beginning of commercial production of the business component.

(B) Adaptation of existing business components. Any research related to the adaptation of an existing business component to a particular customer's requirement or need.

(C) Duplication of existing business component. Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

(D) Surveys, studies, etc. Any-

(i) efficiency survey,

(ii) activity relating to management function or technique,

(iii) market research, testing, or development (including advertising or promotions),

(iv) routine data collection, or

(v) routine or ordinary testing or inspection for quality control.

(E) Computer software. Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in-

(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

(ii) a production process with respect to which the requirements of paragraph (1) are met.

(F) Foreign research. Any research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States.

(G) Social sciences, etc. Any research in the social sciences, arts, or humanities.

(H) Funded research. Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

(e) Credit allowable with respect to certain payments to qualified organizations for basic research.

For purposes of this section -

(1) In general.

In the case of any taxpayer who makes basic research payments for any taxable year-

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of-

(i) such basic research payments, over

(ii) the qualified organization base period amount, and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1) .

(2) Basic research payments defined.

For purposes of this subsection -

(A) In general. The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if-

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

(B) Exception to requirement that research be performed by the organization. In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6) , clause (ii) of subparagraph (A) shall not apply.

(3) Qualified organization base period amount.

For purposes of this subsection , the term "qualified organization base period amount" means an amount equal to the sum of-

(A) the minimum basic research amount, plus

(B) the maintenance-of-effort amount.

(4) Minimum basic research amount.

For purposes of this subsection -

(A) In general. The term "minimum basic research amount" means an amount equal to the greater of-

(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for-

(I) any in-house research expenses, and

(II) any contract research expenses, or

(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

(B) Floor amount. Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection .

(5) Maintenance-of-effort amount.

For purposes of this subsection -

(A) In general. The term "maintenance-of-effort amount" means, with respect to any taxable year, an amount equal to the excess (if any) of-

(i) an amount equal to-

(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over

(ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

(B) Nondesignated university contributions. For purposes of this paragraph , the term "nondesignated university contribution" means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A) -

(i) for which a deduction was allowable under section 170 , and

(ii) which was not taken into account-

(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

(II) as a basic research payment for purposes of this section .

(C) Cost-of-living adjustment defined.

(i) In general. The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3) , by substituting "calendar year 1987" for "calendar year 1992" in subparagraph (B) thereof .

(ii) Special rule where base period ends in a calendar year other than 1983 or 1984. If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(B) shall, for purposes of this paragraph , be applied by substituting the calendar year in which such base period ends for 1992. Such substitution shall be in lieu of the substitution under clause (i) .

(6) Qualified organization.

For purposes of this subsection , the term "qualified organization" means any of the following organizations:

(A) Educational institutions. Any educational organization which-

(i) is an institution of higher education (within the meaning of section 3304(f)), and

(ii) is described in section 170(b)(1)(A)(ii) .

(B) Certain scientific research organizations. Any organization not described in subparagraph (A) which-

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) ,

(ii) is organized and operated primarily to conduct scientific research, and

(iii) is not a private foundation.

(C) Scientific tax-exempt organizations. Any organization which-

(i) is described in -

(I) section 501(c)(3) (other than a private foundation), or

(II) section 501(c)(6) ,

(ii) is exempt from tax under section 501(a) ,

(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

(iv) currently expends-

(I) substantially all of its funds, or

(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A) .

(D) Certain grant organizations. Any organization not described in subparagraph (B) or (C) which-

(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i) ,

(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940 , relating to excise tax based on investment income).

(7) Definitions and special rules.

For purposes of this subsection -

(A) Basic research. The term "basic research" means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include-

(i) basic research conducted outside of the United States, and

(ii) basic research in the social sciences, arts, or humanities.

(B) Base period. The term "base period" means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

(C) Exclusion from incremental credit calculation. For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)

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(i) shall not be treated as qualified research expenses under subsection (a)(1)(A) , and

(ii) shall not be included in the computation of base amount under subsection (a)(1)(B) .

(D) Trade or business qualification. For purposes of applying subsection (b)(1) to this subsection , any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

(E) Certain corporations not eligible. The term "corporation" shall not include-

(i) an S corporation,

(ii) a personal holding company (as defined in section 542) , or

(iii) a service organization (as defined in section 414(m)(3)).

(f) Special rules.

For purposes of this section -

(1) Aggregation of expenditures.

(A) Controlled group of corporations. In determining the amount of the credit under this section -

(i) all members of the same controlled group of corporations shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such member shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by such controlled group for purposes of this section.

(B) Common control. Under regulations prescribed by the Secretary, in determining the amount of the credit under this section -

(i) all trades or businesses (whether or not incorporated) which are under common control shall be treated as a single taxpayer, and

(ii) the credit (if any) allowable by this section to each such person shall be determined on a proportionate basis to its share of the aggregate of the qualified research expenses, basic research payments, and amounts paid or incurred to energy research consortiums, taken into account by all such persons under common control for purposes of this section.

The regulations prescribed under this subparagraph shall be based on principles similar to the principles which apply in the case of subparagraph (A) .

(2) Allocations.

(A) Pass-thru in the case of estates and trusts. Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

(B) Allocation in the case of partnerships. In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

(3) Adjustments for certain acquisitions, etc.
Under regulations prescribed by the Secretary-

(A) Acquisitions.

(i) In general. If a person acquires the major portion of either a trade or business or a separate unit of a trade or business (hereinafter in this paragraph referred to as the "acquired business") of another person (hereinafter in this paragraph referred to as the "predecessor"), then the amount of qualified research expenses paid or incurred by the acquiring person during the measurement period shall be increased by the amount determined under clause (ii) , and the gross receipts of the acquiring person for such period shall be increased by the amount determined under clause (iii) .

(ii) amount determined with respect to qualified research expenses. The amount determined under this clause is

(I) for purposes of applying this section for the taxable year in which such acquisition is made, the acquisition year amount, and

(II) for purposes of applying this section for any taxable year after the taxable year in which such acquisition is made, the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period.

(iii) Amount determined with respect to gross receipts. The amount determined under this clause is the amount which would be determined under clause (ii) if "the gross receipts of" were substituted for "the qualified research expenses paid or incurred by" each place it appears in clauses (ii) and (iv) .

(iv) acquisition year amount. For purposes of clause (ii) , the acquisition year amount is the amount equal to the product of

(I) the qualified research expenses paid or incurred by the predecessor with respect to the acquired business during the measurement period, and

(II) the number of days in the period beginning on the date of the acquisition and ending on the last day the taxable year in which the acquisition is made, divided by the number of days in the acquiring person's taxable year.

(v) special rules for coordinating taxable years. In the case of an acquiring person and a predecessor whose taxable years do not begin on the same date

(I) each reference to a taxable year in clauses (ii) and (iv) shall refer to the appropriate taxable year of the acquiring person,

(II) the qualified research expenses paid or incurred by the predecessor, and the gross receipts of the predecessor, during each taxable year of the predecessor any portion of which is part of the measurement period shall be allocated equally among the days of such taxable year,

(III) the amount of such qualified research expenses taken into account under clauses (ii) and (iv) with respect to a taxable year of the acquiring person shall be equal to the total of the expenses attributable under subclause (II) to the days occurring during such taxable year, and

(IV) the amount of such gross receipts taken into account under clause (iii) with respect to a taxable year of the acquiring person shall be equal to the total of the gross receipts attributable under subclause (II) to the days occurring during such taxable year

(vi) measurement period. For purposes of this subparagraph, the term "measurement period" means, with respect to the taxable year of the acquiring person for which the credit is determined, any period of the acquiring person preceding such taxable year which is taken into account for purposes of determining the credit for such year.

(B) Dispositions. If the predecessor furnished to the acquiring person such information as is necessary for the application of subparagraph (A) , then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by, and the gross receipts of, the predecessor during the measurement period (as defined in subparagraph (A)(vi) , determined by substituting "predecessor" for "acquiring person" each place it appears) shall be reduced by

(i) in the case of the taxable year in which such disposition is made, an amount equal to the product of

(I) the qualified research expenses paid or incurred by, or gross receipts of, the predecessor with respect to the acquired business during the measurement period (as so defined and so determined), and

(II) the number of days in the period beginning on the date of acquisition (as determined for purposes of subparagraph (A)(i)(II)) and ending on the last day of the taxable year of the predecessor in which the disposition is made, divided by the number of days in the taxable year of the predecessor, and

(ii) in the case of any taxable year ending after the taxable year in which such disposition is made, the amount described in clause (i)(I) .

(C) Certain reimbursements taken into account in determining fixed-base percentage. If during any of the 3 taxable years following the taxable year in which a disposition to which subparagraph (B) applies occurs, the disposing taxpayer (or a person with whom the taxpayer is required to aggregate expenditures under paragraph (1)) reimburses the acquiring person (or a person

required to so aggregate expenditures with such person) for research on behalf of the taxpayer, then the amount of qualified research expenses of the taxpayer for the taxable years taken into account in computing the fixed-based percentage shall be increased by the lesser of-

(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph .

(4) Short taxable years.

In the case of any short taxable year, qualified research expenses and gross receipts shall be annualized in such circumstances and under such methods as the Secretary may prescribe by regulation.

(5) Controlled group of corporations.

The term "controlled group of corporations" has the same meaning given to such term by section 1563(a) , except that-

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1) , and

(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563 .

(6) Energy research consortium.

(A) In general. The term "energy research consortium" means any organization-

(i) which is-

(I) described in section 501(c)(3) and is exempt from tax under section 501(a) and is organized and operated primarily to conduct energy research, or

(II) organized and operated primarily to conduct energy research in the public interest (within the meaning of section 501(c)(3)),

(ii) which is not a private foundation,

(iii) to which at least 5 unrelated persons paid or incurred during the calendar year in which the taxable year of the organization begins amounts (including as contributions) to such organization for energy research, and

(iv) to which no single person paid or incurred (including as contributions) during such calendar year an amount equal to more than 50 percent of the total amounts received by such organization during such calendar year for energy research.

(B) Treatment of persons. All persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as related persons for purposes

of subparagraph (A)(iii) and as a single person for purposes of subparagraph (A)(iv) .

(C) Foreign research. For purposes of subsection (a)(3) , amounts paid or incurred for any energy research conducted outside the United States, the Commonwealth of Puerto Rico, or any possession of the United States shall not be taken into account.

(D) Denial of double benefit. Any amount taken into account under subsection (a)(3) shall not be taken into account under paragraph (1) or (2) of subsection (a) .

(E) Energy research. The term "energy research" does not include any research which is not qualified research.

(g) Special rule for pass-thru of credit.

In the case of an individual who-

(1)
owns an interest in an unincorporated trade or business,

(2)
is a partner in a partnership,

(3)
is a beneficiary of an estate or trust, or

(4)
is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39 ; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39 .

(h) Treatment of credit for qualified small businesses.

(1) In general.

At the election of a qualified small business for any taxable year, section 3111(f) shall apply to the payroll tax credit portion of the credit otherwise determined under subsection (a) for the taxable year and such portion shall not be treated (other than for purposes of section 280C) as a credit determined under subsection (a) .

(2) Payroll tax credit portion.

For purposes of this subsection, the payroll tax credit portion of the credit determined under subsection (a) with respect to any qualified small business for any taxable year is the least of-

- (A) the amount specified in the election made under this subsection,
- (B) the credit determined under subsection (a) for the taxable year (determined before the application of this subsection), or
- (C) in the case of a qualified small business other than a partnership or S corporation, the amount of the business credit carryforward under section 39 carried from the taxable year (determined before the application of this subsection to the taxable year).

(3) Qualified small business.
For purposes of this subsection-

(A) In general. The term "qualified small business" means, with respect to any taxable year-

(i) a corporation or partnership, if-

(I) the gross receipts (as determined under the rules of section 448(c)(3) , without regard to subparagraph (A) thereof) of such entity for the taxable year is less than \$5,000,000, and

(II) such entity did not have gross receipts (as so determined) for any taxable year preceding the 5-taxable-year period ending with such taxable year, and

(ii) any person (other than a corporation or partnership) who meets the requirements of subclauses (I) and (II) of clause (i) , determined-

(I) by substituting "person" for "entity" each place it appears, and

(II) by only taking into account the aggregate gross receipts received by such person in carrying on all trades or businesses of such person.

(B) Limitation. Such term shall not include an organization which is exempt from taxation under section 501 .

(4) Election.

(A) In general. Any election under this subsection for any taxable year-

(i) shall specify the amount of the credit to which such election applies,

(ii) shall be made on or before the due date (including extensions) of-

(I) in the case of a qualified small business which is a partnership, the return required to be filed under section 6031 ,

(II) in the case of a qualified small business which is an S corporation, the return required to be filed under section 6037 , and

(III) in the case of any other qualified small business, the return of tax for the taxable year, and

(iii) may be revoked only with the consent of the Secretary.

(B) Limitations.

(i) Amount. The amount specified in any election made under this subsection shall not exceed \$250,000.

(ii) Number of taxable years. A person may not make an election under this subsection if such person (or any other person treated as a single taxpayer with such person under paragraph (5)(A)) has made an election under this subsection for 5 or more preceding taxable years.

(C) Special rule for partnerships and S corporations. In the case of a qualified small business which is a partnership or S corporation, the election made under this subsection shall be made at the entity level.

(5) Aggregation rules.

(A) In general. Except as provided in subparagraph (B) , all persons or entities treated as a single taxpayer under subsection (f)(1) shall be treated as a single taxpayer for purposes of this subsection.

(B) Special rules. For purposes of this subsection and section 3111(f) -

(i) each of the persons treated as a single taxpayer under subparagraph (A) may separately make the election under paragraph (1) for any taxable year, and

(ii) the \$250,000 amount under paragraph (4)(B)(i) shall be allocated among all persons treated as a single taxpayer under subparagraph (A) in the same manner as under subparagraph (A)(ii) or (B)(ii) of subsection (f)(1) , whichever is applicable.

(6) Regulations.

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including-

(A) regulations to prevent the avoidance of the purposes of the limitations and aggregation rules under this subsection through the use of successor companies or other means,

(B) regulations to minimize compliance and recordkeeping burdens under this subsection, and

(C) regulations for recapturing the benefit of credits determined under section 3111(f) in cases where there is a subsequent adjustment to the payroll tax credit portion of the credit determined under subsection (a) , including requiring amended income tax returns in the cases where there is such an adjustment.