

Congressional Confusion About the Federal Income Tax Credit for Research Expenditures

November 29, 2017

All congressional committees that have issued explanations of the pending *Tax Cuts and Jobs Act* may not be speaking with one voice about supporting the federal income tax credit for research expenses. That is cause for concern because the divergence of explanations is not readily apparent, and not all explanations may be favorable.

The House Ways and Means Committee explanation said that “by preserving the research and development tax credit, the pending *Tax Cuts and Jobs Act* will help our businesses and workers develop cutting-edge ‘Made in America’ products and services that raise the bar globally for quality and innovation. ... And when our ‘Made in America’ products win around the world, that grows our economy and creates more good-paying jobs here at home.” That explanation is clear and obviously favorable.

The Congressional Joint Committee on Taxation also published an explanation of the *Tax Cuts and Jobs Act*, but the explanation has subtle language that would make proof of entitlement to the credit substantially more difficult for taxpayers that conduct research to develop new or improved products. To claim the credit under the law now in effect, a taxpayer has to prove that its activities are intended to discover information that would eliminate “uncertainty” concerning the development or improvement of a product. Uncertainty is proved if the information available to the taxpayer does not establish the *capability or method* for developing or improving the product or *the appropriate design* of the product. Thus, it should be clear that a taxpayer that expends funds to determine “the appropriate design of a product” is entitled to the credit, assuming other requirements are satisfied, even if the taxpayer is not uncertain about capability and method.

The Joint Committee, however, described “uncertainty” as existing “when information available to the taxpayer is not sufficient to ascertain the capability or method for developing, improving, *and/or* appropriately designing the product.” The current applicable tax regulation does not say “*and/or*.” A taxpayer is not required to prove uncertainty of capability, method, *and* appropriate design to claim the credit.

Perhaps the Joint Committee’s use of “*and/or*” was a slip of the pen, or, perhaps more nefariously, the Justice Department prevailed on Joint Committee staff to include language in the tax bill’s legislative history supportive of the Justice Department’s current research credit litigating position.

The Justice Department is presently arguing that a taxpayer is uncertain about the appropriate design of a product only if the taxpayer does not know “*how*” to design the product, which is highly unlikely when the taxpayer employs scientists and engineers who are professionally capable and methodical.

The Justice Department’s litigating position broadly undercuts the research credit because product design research projects might well be unqualified. This is why the Joint Committee explanation of the Tax Cut and Jobs Act is troublesome. The Justice Department should not be able to fortify its contorted argument with a spurious comment by the Joint Committee, and this is why the Joint Committee explanation should be clarified.

Continued

We encourage you to contact your lobbyists and congressional representatives to ensure that the Joint Committee explanation is amended to avoid confusion about what a taxpayer needs to prove to obtain the credit. We also encourage you to contact any member of our **tax team** with questions related to the pending legislation regarding the research credit.

Gary Glenn
+1.248.267.3299
glenn@millercanfield.com