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(Original Signature of Member)

110TH CONGRESS  
2D SESSION

# H. R.

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To amend the Internal Revenue Code of 1986 to provide incentives to improve America's research competitiveness, and for other purposes.

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## IN THE HOUSE OF REPRESENTATIVES

Mr. MCNERNEY introduced the following bill; which was referred to the Committee on \_\_\_\_\_

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# A BILL

To amend the Internal Revenue Code of 1986 to provide incentives to improve America's research competitiveness, 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 "Innovation Tax Credit  
5 Act of 2008".

1 **SEC. 2. SIMPLIFICATION OF RESEARCH AND DEVELOP-**  
2 **MENT CREDIT.**

3 (a) TRANSITION TO FULLY-IMPLEMENTED SIM-  
4 PLIFIED CREDIT FOR QUALIFIED RESEARCH EX-  
5 PANSES.—

6 (1) PHASE-OUT OF TRADITIONAL CREDIT.—

7 Section 41(a) of the Internal Revenue Code of 1986  
8 is amended—

9 (A) by striking “20 percent” each place it  
10 appears and inserting “the applicable percent-  
11 age”, and

12 (B) by adding at the end the following new  
13 flush sentence:

14 “For purposes of this subsection, the term ‘applicable per-  
15 centage’ means 20 percent with respect to taxable years  
16 beginning in 2008 and 2009.”.

17 (2) PHASE-IN OF SIMPLIFIED CREDIT.—Section  
18 41(c)(5)(A) of such Code is amended—

19 (A) by striking “12 percent” and inserting  
20 “the applicable percentage”, and

21 (B) by adding at the end the following new  
22 sentence: “For purposes of the preceding sen-  
23 tence, the term ‘applicable percentage’ means  
24 16 percent with respect to taxable years begin-  
25 ning in 2008 and 18 percent with respect to  
26 taxable years beginning in 2009”.

1           (3) EFFECTIVE DATE.—The amendments made  
2           by this subsection shall apply to taxable years begin-  
3           ning after December 31, 2007.

4           (b) FULLY-IMPLEMENTED SIMPLIFIED CREDIT FOR  
5 QUALIFIED RESEARCH EXPENSES.—

6           (1) IN GENERAL.—Subsection (a) of section 41  
7           of the Internal Revenue Code of 1986 (relating to  
8           credit for increasing research activities) is amended  
9           to read as follows:

10          “(a) DETERMINATION OF CREDIT.—

11           “(1) IN GENERAL.—For purposes of section 38,  
12           the research credit determined under this section for  
13           the taxable year shall be equal to 20 percent of so  
14           much of the qualified research expenses for such  
15           taxable year as exceeds 50 percent of the average  
16           qualified research expenses for the 3 taxable years  
17           preceding the taxable year for which the credit is  
18           being determined.

19           “(2) SPECIAL RULE IN CASE OF NO QUALIFIED  
20           RESEARCH EXPENSES IN ANY OF 3 PRECEDING TAX-  
21           ABLE YEARS.—

22           “(A) TAXPAYERS TO WHICH PARAGRAPH  
23           APPLIES.—The credit under this section shall  
24           be determined under this paragraph if the tax-  
25           payer has no qualified research expenses in at

1           least 1 of the 3 taxable years preceding the tax-  
2           able year for which the credit is being deter-  
3           mined.

4                   “(B) CREDIT RATE.—The credit deter-  
5           mined under this paragraph shall be equal to  
6           10 percent of the qualified research expenses  
7           for the taxable year.”.

8           (2) CONFORMING AMENDMENT.—Section 41 of  
9           such Code is amended by striking subsection (c).

10          (c) UNIFORM REIMBURSEMENT RATES FOR ALL  
11         CONTRACT RESEARCH EXPENSES OTHER THAN  
12         AMOUNTS PAID FOR BASIC RESEARCH.—

13                 (1) IN GENERAL.—Section 41(b)(3) of the In-  
14         ternal Revenue Code of 1986 (relating to contract  
15         research expenses) is amended—

16                         (A) by striking “65 percent” and inserting  
17                         “80 percent”, and

18                         (B) by striking subparagraphs (C) and  
19                         (D).

20           (2) BASIC RESEARCH PAYMENTS.—Section  
21         41(b) of such Code is amended by redesignating  
22         paragraph (4) as paragraph (5) and by inserting  
23         after paragraph (3) the following new paragraph:

24                         “(4) BASIC RESEARCH PAYMENTS.—

1           “(A) IN GENERAL.—In the case of basic  
2 research payments by the taxpayer, paragraph  
3 (3)(A) shall be applied by substituting ‘100 per-  
4 cent’ for ‘80 percent’.

5           “(B) BASIC RESEARCH PAYMENTS DE-  
6 FINED.— For purposes of this paragraph—

7           “(i) IN GENERAL.—The term ‘basic  
8 research payment’ means, with respect to  
9 any taxable year, any amount paid in cash  
10 during such taxable year by a corporation  
11 to any qualified organization for basic re-  
12 search but only if—

13           “(I) such payment is pursuant to  
14 a written agreement between such cor-  
15 poration and such qualified organiza-  
16 tion, and

17           “(II) such basic research is to be  
18 performed by such qualified organiza-  
19 tion.

20           “(ii) EXCEPTION TO REQUIREMENT  
21 THAT RESEARCH BE PERFORMED BY THE  
22 ORGANIZATION.—In the case of a qualified  
23 organization described in clause (iii) or (iv)  
24 of subparagraph (C), subclause (II) of  
25 clause (i) shall not apply.

1           “(C) QUALIFIED ORGANIZATION.—For  
2 purposes of this paragraph, the term ‘qualified  
3 organization’ means any of the following orga-  
4 nizations:

5           “(i) EDUCATIONAL INSTITUTIONS.—  
6 Any educational organization which—

7           “(I) is an institution of higher  
8 education (within the meaning of sec-  
9 tion 3304(f)), and

10           “(II) is described in section  
11 170(b)(1)(A)(ii).

12           “(ii) CERTAIN SCIENTIFIC RESEARCH  
13 ORGANIZATIONS.—Any organization not  
14 described in clause (i) which—

15           “(I) is described in section  
16 501(c)(3) and is exempt from tax  
17 under section 501(a),

18           “(II) is organized and operated  
19 primarily to conduct scientific re-  
20 search, and

21           “(III) is not a private founda-  
22 tion.

23           “(iii) SCIENTIFIC TAX-EXEMPT ORGA-  
24 NIZATIONS.— Any organization which—

1                   “(I) is described in section  
2                   501(c)(3) (other than a private foun-  
3                   dation) or section 501(c)(6),

4                   “(II) is exempt from tax under  
5                   section 501(a),

6                   “(III) is organized and operated  
7                   primarily to promote scientific re-  
8                   search by qualified organizations de-  
9                   scribed in clause (i) pursuant to writ-  
10                  ten research agreements, and

11                  “(IV) currently expends substan-  
12                  tially all of its funds or substantially  
13                  all of the basic research payments re-  
14                  ceived by it for grants to, or contracts  
15                  for basic research with, an organiza-  
16                  tion described in clause (i).

17                  “(iv) CERTAIN GRANT ORGANIZA-  
18                  TIONS.— Any organization not described  
19                  in clause (ii) or (iii) which—

20                  “(I) is described in section  
21                  501(c)(3) and is exempt from tax  
22                  under section 501(a) (other than a  
23                  private foundation),

24                  “(II) is established and main-  
25                  tained by an organization established

1 before July 10, 1981, which meets the  
2 requirements of subclause (I),

3 “(III) is organized and operated  
4 exclusively for the purpose of making  
5 grants to organizations described in  
6 clause (i) pursuant to written research  
7 agreements for purposes of basic re-  
8 search, and

9 “(IV) makes an election, rev-  
10 ocable only with the consent of the  
11 Secretary, to be treated as a private  
12 foundation for purposes of this title  
13 (other than section 4940, relating to  
14 excise tax based on investment in-  
15 come).

16 “(D) DEFINITIONS AND SPECIAL RULES.—  
17 For purposes of this paragraph—

18 “(i) BASIC RESEARCH.—The term  
19 ‘basic research’ means any original inves-  
20 tigation for the advancement of scientific  
21 knowledge not having a specific commercial  
22 objective, except that such term shall not  
23 include—

24 “(I) basic research conducted  
25 outside of the United States, and

1                   “(II) basic research in the social  
2                   sciences, arts, or humanities.

3                   “(ii) TRADE OR BUSINESS QUALIFICA-  
4                   TION.—For purposes of applying para-  
5                   graph (1) to this paragraph, any basic re-  
6                   search payments shall be treated as an  
7                   amount paid in carrying on a trade or  
8                   business of the taxpayer in the taxable  
9                   year in which it is paid (without regard to  
10                  the provisions of paragraph (3)(B)).

11                  “(iii) CERTAIN CORPORATIONS NOT  
12                  ELIGIBLE.—The term ‘corporation’ shall  
13                  not include—

14                         “(I) an S corporation,

15                         “(II) a personal holding company  
16                         (as defined in section 542), or

17                         “(III) a service organization (as  
18                         defined in section 414(m)(3)).”.

19                  (3) CONFORMING AMENDMENTS.—

20                         (A) Section 41 of such Code is amended by  
21                         striking subsection (e).

22                         (B) Section 41(f) of such Code is amended  
23                         by striking paragraph (6).

1 (C) Section 45C(b)(1)(B)(ii) of such Code  
2 is amended by striking “65 percent” and insert-  
3 ing “80 percent”.

4 (d) PERMANENT EXTENSION OF CREDIT.—

5 (1) IN GENERAL.—Section 41 of the Internal  
6 Revenue Code of 1986 is amended by striking sub-  
7 section (h).

8 (2) CONFORMING AMENDMENT.—Paragraph (1)  
9 of section 45C(b) of such Code is amended by strik-  
10 ing subparagraph (D).

11 (3) EFFECTIVE DATE.—The amendments made  
12 by this subsection shall apply to taxable years begin-  
13 ning after December 31, 2006.

14 (e) CONFORMING AMENDMENTS.—

15 (1) Section 41 of the Internal Revenue Code of  
16 1986 is amended by redesignating subsections (d),  
17 (f), and (g) as subsections (c), (d), and (e), respec-  
18 tively.

19 (2) Paragraphs (2)(A) and (5) (as redesignated  
20 by subsection (b)(2)) of section 41(b) of such Code  
21 are each amended by striking “subsection (f)(1)”  
22 and inserting “subsection (d)(1)”.

23 (3) Sections 45C(d)(3), 45G(e)(2), and  
24 936(h)(5)(C)(i)(IV)(c) of such Code are each

1 amended by striking “section 41(f)” and inserting  
2 “section 41(d)”.

3 (4) Section 54(l)(3)(A) of such Code is amend-  
4 ed by striking “section 41(g)” and inserting “section  
5 41(e)”.

6 (5) Section 170(e)(4)(B)(i) of such Code is  
7 amended by striking “subparagraph (A) or subpara-  
8 graph (B) of section 41(e)(6)” and inserting “clause  
9 (i) or (ii) of section 41(b)(4)(C)”.

10 (6) Sections 197(f)(1)(C), 197(f)(9)(C)(i)(II),  
11 and 280C(b)(3) of such Code are each amended by  
12 striking “section 41(f)(1)” and inserting “section  
13 41(d)(1)”.

14 (7) Section 280C(b)(3) of such Code is amend-  
15 ed by striking “section 41(f)(5)” and inserting “sec-  
16 tion 41(d)(5)”.

17 (8) Section 280C(b)(3) of such Code is amend-  
18 ed by striking “section 41(f)(1)(B)” and inserting  
19 “section 41(d)(1)(B)”.

20 (9) Section 280C(e)(1) of such Code is amend-  
21 ed by striking “section 41(e)(2)” and inserting “sec-  
22 tion 41(b)(4)(B)”.

23 (10) Section 280C(e)(2)(A) of such Code is  
24 amended by striking “section 41(a)(1)” and insert-  
25 ing “section 41(a)”.

1           (11) Sections 936(j)(5)(D) and 965(c)(2)(C)(i)  
2           of such Code are each amended by striking “section  
3           41(f)(3)” and inserting “section 41(d)(3)”.

4           (f) EFFECTIVE DATE.—Except as otherwise provided  
5           in this section, the amendments made by this section shall  
6           apply to taxable years beginning after December 31, 2009.

7           (g) STUDY OF COMPLIANCE WITH SUBSTANTIATION  
8           REQUIREMENTS.—The Secretary of the Treasury or his  
9           delegate shall, not later than 1 year after the date of the  
10          enactment of this Act, conduct a study of taxpayer compli-  
11          ance with the substantiation requirements for claiming the  
12          credit allowed under section 41 of the Internal Revenue  
13          Code of 1986, including a study of—

14                (1) whether taxpayers maintain adequate record  
15                keeping to determine eligibility for, and correct  
16                amount of, the credit,

17                (2) the impact of failure to comply with such  
18                requirements on the oversight and enforcement re-  
19                sponsibilities of the Internal Revenue Service, and

20                (3) the burdens imposed on other taxpayers by  
21                failure to comply with such requirements.

22          The Secretary shall report the results of such study to  
23          the Committee on Ways and Means of the House of Rep-  
24          resentatives and the Committee on Finance of the Senate,  
25          including any recommendations for administrative or leg-

1 islative actions which could be taken to improve compli-  
2 ance with such requirements.