H.R. 11 Could Double Research Credit and Eliminate 2022 Research Expense Amortization Requirement

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On October 9, 2020, the top Republican on the House Ways and Means Committee Kevin Brady (R-TX) and House Republican Leader Kevin McCarthy (R-CA) introduced H.R. 11, the Commitment to American GROWTH Act. This bill will result in major changes to the §41 research credit and §174's treatment of research expenses if passed by Congress and signed into law by the President.

H.R. 11 calls for the repeal of the requirement that taxpayers begin amortizing research costs under §174 for tax years beginning after December 31, 2021. You may recall that the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) amended §174 by requiring §174 expenses to be amortized and deducted over five years. Prior to the TCJA, §174 allowed taxpayers to immediately expense research expenses or elect to amortize these expenses and deduct them over a period of not less than 60 months. The TCJA modifications for 2022 will require taxpayers to change accounting methods.

The TCJA change in accounting for research expenses under §174 has been criticized by numerous commentators and industry representatives. Some of these critics have stated that the changes to §174 required by the TCJA will raise the cost of investment in new technologies; discourage research and development in many important industries (pharmaceuticals, etc.); and increase the complexity of the Internal Revenue Code and taxpayers' books and records. Many of these commentators have hoped or expected Congress to address the perceived §174 issues caused by the TCJA, and H.R. 11 proposes to do just that.

If enacted, H.R. 11 will essentially bring back the pre-TCJA §174 rules by allowing taxpayers to deduct research expenses in the year they occur and eliminate the requirement that these costs be amortized over five years, beginning in 2022. As with pre-TCJA §174, H.R. 11 will allow taxpayers to elect to amortize their research expenses over a period of not less than 60 months.

H.R. 11 would also double the research tax credit rates. The traditional or regular credit rate would increase from 20% to 40%; the Alternative Simplified Credit (ASC) rate would increase from 14% to 28%; the start-up company rate would increase from 6% to 14%; the Small Business credit cap against payroll taxes would increase from $250,000 to $500,000. H.R. 11 would also allow American businesses to bring back intellectual property (IP) developed offshore without any immediate U.S. tax cost.

Among other provisions, H.R. 11 would provide new incentives in addition to the research credit. These new incentives include a credit of 10.5% against the income from the domestic manufacture and sale of active pharmaceutical ingredients (API) and medical countermeasures. It would also introduce a 30% credit for new investments in advanced manufacturing equipment or machinery used in the U.S. to manufacture medicines and medical devices. And lastly, it provides that pre-revenue companies (defined as small businesses engaging in certain medical research) may receive an annual refund of their §41 research credit.

Whether such an ambitious piece of legislation can be passed by Congress in the few weeks remaining before election day is an open question, this is especially true given the negative impact H.R. 11 would have on Treasury's top-line annual tax collections. However, it is possible that H.R. 11 or some of its provisions could become part of the latest Covid-19 stimulus package currently being debated in the House of Representatives. Additionally, H.R. 11 could be taken up by the lame-duck session of Congress or the new Congress next spring to help boost an economy still slowed by the U.S. Covid-19 response. Whatever the fate of H.R. 11, A&M Taxand will keep you updated on the progress of this major piece of proposed research credit tax legislation.

If you have any questions or would like to discuss how these potential changes would affect your company, please don't hesitate to reach out to an A&M RCIS representative.

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