

THE NEW BASIC RESEARCH CREDIT: AN INCENTIVE FOR RESEARCH INSTITUTIONS AND CORPORATIONS

What is the Basic Research Credit?

The Basic Research Credit is a new incentive adopted in the 1986 Tax Reform Act to encourage companies to increase their spending on basic research at universities and other non-profit research institutions. For the first time, companies will be able to reduce the cost of conducting basic research by claiming a 20% credit on research grants, contributions, and contracts at qualifying facilities. Research institutions can urge corporations to expand their basic research investments by alerting them to the new credit.

The new credit went into effect on January 1, 1987, and will extend until December 31, 1988.

The Basic Research Credit was designed specifically to encourage company support of basic research in science, engineering and mathematics. By adopting the new credit, Congress sought to encourage U.S. competitiveness through technological innovation and to speed the process by which new ideas are discovered by university researchers and translated by U.S. companies into new products or industrial processes.

How Does the New Basic Research Credit Work?

The new Basic Research Credit can be claimed at the fixed rate of 20%. Unlike the Research and Development (R&D) Tax Credit which is incremental and can be claimed only for increases in R&D spending, the new credit is nonincremental after a minimum level of payments is made. Therefore, companies entering into multiyear contracts for basic research at qualified institutions will be able to obtain the credit on each year's payment as long as its payments exceed a fixed base.

Further, the new Basic Research Credit applies at a significantly higher rate than the R&D Tax Credit for contractual research. The new credit equals 20% of the total contract research payments — with certain limitations — over a fixed base. In contrast, the R&D Tax Credit can be claimed for only 20% of 65% of the *increase* in contract research payments over a rolling base.

The new Basic Research Credit applies to company grants, contributions, and contracts for basic research conducted at qualifying institutions. Thus, companies will be able to claim the credit for basic research contracts even if they enter into an agreement with the performing institution that reserves significant rights to any resulting technology to the company.

What are the Restrictions?

The Minimum Basic Research Amount. Under the Tax Reform Act, the "minimum basic research amount" equals the greater of:

- A company's average credit-eligible basic research payments for tax years beginning in 1981, 1982, and 1983. These payments can be determined from amounts taken into account as university basic research payments (under Code Section 30(e)) on a taxpayer's return for those years.
- One percent of a corporation's research expenditures for all types of research eligible for the credit in 1981, 1982, and 1983. This amount is simply based on the total taken into account for R&D credit purposes in those years.

A special exception to the above rule is provided for companies not in existence during one or more of the 1981-83 years. These companies are to compute their minimum basic research amount as an average of any amounts actually incurred in any of those years in which the company was in existence, but in no case can the amount be less than one-half of total current payments to qualified institutions for basic research.

The Maintenance-of-Effort Amount. In general, the maintenance-of-effort provision will affect companies only if their overall increase in charitable contributions to universities does not keep pace with the rate of inflation since the 1981-83 period.

What Are Eligible Institutions?

- Institutions for Higher Education
- Scientific Research Organizations
- Tax-Exempt Organizations to Fund Basic Research
- Certain Other Charitable Organizations

What is "Basic Research"?

The operative definition of basic research for purposes of the credit is "any original investigation for the advancement of scientific knowledge not having a specific commercial objective."

In all cases, it is important to specify in the required written research agreement that the research to be undertaken is limited to basic research under the above definition and that the performing institution not take any position or make any statement to the contrary.

Are There Other Requirements?

In order to claim the credit, companies must enter into a written agreement with the performing institution.