

Notice of Proposed Rulemaking and Notice of Public Hearing

Credit for Increasing Research Activities

REG-105606-99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the computation of the credit for increasing research activities (the research credit) for members of a controlled group and the allocation of the credit under section 41(f) of the Internal Revenue Code. These proposed regulations are intended to provide guidance on the proper method for computing the research credit for members of a controlled group and the proper method for allocating the group credit to members of the group. These proposed regulations reflect changes to section 41 made by the Revenue Reconciliation Act of 1989 (the 1989 Act). This document also provides notice of a public hearing on these regulations.

DATES: Written or electronic comments must be received no later than April 5, 2000. Outlines of topics to be discussed at the public hearing scheduled for April 26, 2000 at 10 a.m. must be received by April 5, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-105606-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-105606-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at:

<http://www.irs.gov/prod/taxregs/reglist.html>. The public hearing will be held in

room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Lisa J. Shuman at (202)622-3120 (not a toll-free number); concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, La Nita Van Dyke at (202)622-7190 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by March 6, 2000.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is contained in the preamble under the heading "**Proposed Effective Date**." The information is required by the IRS to ensure that members of a controlled group filing claims for refund based on a change in method of allocating the research credit to members of the group do not together claim in excess of 100% of the credit with respect to prior taxable years.

Estimated total annual reporting burden: 200 hours.

Estimated average annual burden hours per respondent: 20 hours.

Estimated number of respondents: 10.

Estimated frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The research credit provisions originally appeared in section 44F of the Internal Revenue Code of 1954 (the 1954 Code), as added to the 1954 Code by section 221 of the Economic Recovery Tax Act of 1981. Section 471(c) of the Tax Reform Act of 1984 redesignated section 44F as section 30. Section 231 of the Tax Reform Act of 1986 (the 1986 Act) redesignated section 30 as section 41 and substantially modified the research credit provisions. The 1989 Act substantially revised the computation of the research credit.

On May 17, 1989, the IRS published in the **Federal Register** (54 FR 21203) final regulations under section 41. The 1989 final regulations generally do not reflect the amendments to section 41 made by the 1986 Act, the 1989 Act, and other subsequent legislative revisions to the research credit.

The amendments proposed by this document contain proposed rules relating to

the computation of the research credit for members of a controlled group and the allocation of the credit under section 41(f). These proposed regulations reflect changes to the research credit rules made by the 1989 Act and Small Business Job Protection Act of 1996, which introduced the alternative incremental research credit.

Pre-1990 Rules for Computing the Research Credit for Members of a Controlled Group and Allocating the Credit among Members of the Group

Prior to the enactment of the 1989 Act, the research credit was computed by multiplying the credit rate by the excess of the taxpayer's current year qualified research expenses over the average of the taxpayer's qualified research expenses for the preceding three years.

Before amendment by the 1989 Act, section 41(f)(1) provided rules for computing the research credit for members of a controlled group (generally a group of corporations or unincorporated businesses linked by common ownership of more than 50 percent). Section 41(f)(1) treated all members of a controlled group as a single taxpayer for purposes of computing the credit and allocated the credit to the members of the group based on the member's proportionate share of the increase in qualified research expenses giving rise to the credit.

The legislative history to the 1981 Act indicates that the research credit aggregation rules were enacted to ensure that the research credit would be allowed only for actual increases in research expenditures. The aggregation rules were intended to prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related persons. H. Rep. No. 97-201, 1981-3 C.B. (Vol. 2) 364 and Sen. Rep. 97-144, 1981-3 C.B. (Vol. 2) 442.

An example that appears in both §1.41-8(a)(4) of the 1989 regulations and the legislative history to the 1981 Act illustrates the computation and allocation of the research credit under section 41(f)(1) before the 1989 Act amendments to the research credit computation. In the example, the allowable group research credit is allocated among the members experiencing an increase in qualified research expenses over their base period re-

search expenses. The member allocation is based on the ratio that each member's increase in its qualified research expenses over its base period research expenses bears to the sum of the group's increases in qualified research expenses.

Post-1989 Rules for Computing the Research Credit for Members of a Controlled Group and Allocating the Regular Research Credit among Members of the Group

In the 1989 Act, Congress revised the computation of the research credit. Congress retained the incremental structure of the credit but altered the computation to focus on whether and the extent to which a taxpayer increases the proportion of its qualified research expenses relative to its gross receipts.

Under section 41, as amended in 1989, the research credit is computed by multiplying the credit rate by the excess of the taxpayer's current year qualified research expenses over a "base amount." The base amount is defined in section 41(c) as the greater of: (1) fifty percent of the taxpayer's credit year qualified research expenses (the minimum base amount); or, (2) the taxpayer's "fixed-base percentage" times the taxpayer's average annual gross receipts for the four taxable years preceding the taxable year for which the credit is being determined.

In general, a taxpayer's fixed-base percentage is defined in section 41(c)(3)(A) as the ratio that the taxpayer's aggregate qualified research expenses for its taxable years beginning after December 31, 1983, and before January 1, 1989 bear to its aggregate gross receipts for the same period. Section 41(c)(3)(B) provides rules for computing the fixed-base percentage for start-up companies. Section 41(c)(3)(C) provides that the maximum fixed-base percentage is 16%.

Section 41(f)(1), as amended by the 1989 Act, continues to provide rules for computing the research credit for members of a controlled group. As under prior law, all members of a controlled group are treated as a single taxpayer for purposes of computing the credit. However, the allocation rule was amended to eliminate any reference to an "increase" in qualified research expenses. Under the amended allocation rule, the group credit is allocated among the members of the group

based on each member's "proportionate share of the qualified research expenses and basic research payments giving rise to the credit."

In explaining the 1989 Act revisions to the research credit, the House Report simply states that the rules relating to the aggregation of related persons and changes in ownership are the same as under present law with the modification that when a business changes hands, qualified research expenses and gross receipts for periods prior to the change of ownership are treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage. H. Rep. No. 101-247 at 1202. The legislative history to the 1989 Act does not refer to the elimination of the word "increase" from the allocation rule.

In the light of the statutory changes enacted in 1989, taxpayers have questioned the proper method for computing the research credit for members of a controlled group and the proper method for allocating the group credit to members of the group under the new rules.

The proposed regulations provide that, for purposes of computing the group credit, all of the computational rules of section 41 are applied on an aggregate basis. This is consistent with the statutory prescription that the controlled group be treated as a single taxpayer and is necessary to preclude taxpayers from creating artificial increases in the credit by shifting qualified research expenses and gross receipts among commonly controlled or otherwise related persons.

In proposing rules for the allocation of the credit, Treasury and the IRS considered, but were not persuaded by, certain taxpayers' argument that the elimination of the word "increase" from the allocation rule in the statute requires that the credit be allocated on the basis of the gross amount of qualified research expenses incurred by the various members of the controlled group. Treasury and the IRS believe that elimination of the word "increase" was necessitated by the 1989 statutory amendments to the computation of the research credit, which afford a credit in certain circumstances even where the taxpayer (or each member of a controlled group) is decreasing its gross amount of qualified research expenses

(e.g., because the taxpayer's gross receipts also are decreasing). However, there is no indication that the elimination of the word "increase" was intended to suggest that the credit be allocated without regard to its incremental nature. To the contrary, the statutory prescription that the credit be allocated according to each member's proportionate share of the qualified research expenses "giving rise to" the credit supports a rule that allocates the credit to those members whose share of current year qualified research expenses exceeds their share of the base amount. Thus, the proposed regulation provides that the group research credit is allocated to each member based on the ratio that the member's increase in its qualified research expenses over its base amount bears to the sum of each member's increase in qualified research expenses over its base amount. The member's base amount is computed by multiplying the group fixed-base percentage by the member's average annual gross receipts for the four preceding tax years.

In order to prevent manipulation of the amount of credit allocated to a consolidated group of corporations that is a member of a controlled group with other taxpayers, Treasury and the IRS considered a special rule for allocating the research credit that would treat all members of a consolidated group as a single taxpayer for purposes of allocating the research credit among members of the controlled group. Treasury and the IRS request comments on special rules for allocating the research credit among members of a controlled group that contains a consolidated group of corporations.

Allocation of the Credit for Basic Research Payments and the Alternative Incremental Research Credit

The proposed regulations also address the computation and allocation of the group credit for basic research payments (certain amounts paid to qualified organizations for basic research) and for the alternative incremental research credit (an elective alternative method of computing the research credit, under which taxpayers are assigned a lower three-tiered fixed base percentage, and the credit rate is reduced).

As in the case of the regular credit for qualified research expenses, the proposed

regulations provide that all computations with respect to the group credit for basic research payments and the alternative incremental research group credit are undertaken on an aggregate basis. Similarly, these group credits are allocated to the various group members on an incremental basis.

Proposed Effective Date

The regulations generally are proposed to be applicable for taxable years ending on or after the date proposed regulations are filed with the Federal Register, but are also proposed to be retroactive in certain limited circumstances to prevent abuse. To prevent taxpayers that are members of a controlled group from together claiming in excess of 100% of the credit with respect to prior taxable years, the rules for allocating the group credit would apply to any taxable year beginning after December 31, 1989, in which, as a result of inconsistent methods of allocation, the members of a controlled group as a whole claimed more than 100% of the allowable group credit. In the case of a group whose members have different taxable years and whose members used inconsistent methods of allocation, the members of the group as a whole shall be deemed to have claimed more than 100% of the allowable group credit.

No claim for refund (1) attributable to a change in method of allocation; (2) pertaining to a taxable year ending before December 30, 1999; and (3) filed after December 30, 1999, will be allowed unless the taxpayer submits a statement identifying all members of the controlled group for the taxable year at issue. The statement must contain a declaration signed by the taxpayer under penalties of perjury that states: "To the best of my knowledge and belief, taking into account prior claims, this amended claim and any related adjustments, no more than the total amount of the group credit will be allocated to the members of the controlled group."

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b)

of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the expectation that few, if any, small entities will file claims for refund attributable to a change in method of allocating the research credit among members of its controlled group. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) or electronic comments are submitted timely to the IRS. Treasury and the IRS request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for April 26, 2000 at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be dis-

cussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies by April 5, 2000). A period of 10 minutes will be allotted to each person making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Lisa J. Shuman of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §1.41-0, the table of contents is amended by revising the entries for §1.41-8(a), (a)(1), (a)(4), and (b) and adding entries for §1.41-8(a)(5) and (a)(6) to read as follows:

§1.41-0 Table of contents.

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§1.41-8 Aggregation of expenditures.

(a) Controlled group of corporations; trades or businesses under common control.

(1) In general.

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(4) Allocation of credit for basic research

payments.

(5) Allocation of alternative incremental research credit.

(6) Examples.

(b) For taxable years beginning before January 1, 1990.

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Par. 3. In §1.41-8, paragraphs (a)(1), (a)(4), (b), and (c)(1) are revised and paragraphs (a)(5) and (a)(6) are added to read as follows:

§1.41-8 Aggregation of expenditures.

(a) *Controlled group of corporations; trades or businesses under common control—(1) In general.* In determining the amount of the credit for increasing research activities allowed with respect to a trade or business that at the end of its taxable year is a member of a controlled group of corporations or a member of a group of trades or businesses under common control, all members of the group are treated as a single taxpayer. Thus, for purposes of determining the amount of the credit, all of the rules in section 41, including, for example, the rules in section 41(c)(2) (pertaining to the minimum base amount), section 41(c)(3)(B) (pertaining to the fixed-base percentage for start-up companies), and section 41(c)(3)(C) (pertaining to maximum base amount) are applied only to the aggregate computation of the base amount. The credit (if any) allowed to any member is determined on the basis of the ratio that its increase (if any) in its qualified research expenses over its base amount bears to the aggregate increases in qualified research expenses over the base amount of all members of the group. For purposes of the preceding sentence, a member computes its base amount by multiplying the group fixed-base percentage by the member's average annual gross receipts for the four

preceding tax years.

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(4) *Allocation of credit for basic research payments.* The credit (if any) attributable to basic research payments allowed to a member is determined on the basis of the ratio that its excess (if any) of basic research payments over its qualified organization base period amount bears to the aggregate excess of basic research payments over the qualified organization base period amount of all members in the group. For purposes of the preceding sentence, a member computes its qualified organization base period amount using similar principles to those used in paragraph (a)(1) to determine the member's base amount.

(5) *Allocation of alternative incremental research credit.* If the credit is computed under the alternative incremental research credit rules, the credit (if any) allowed to the member is determined on the basis of the ratio that its excess (if any) of qualified research expenses over 1% of its average annual gross receipts for the four taxable years preceding the taxable year for which the credit is being determined bears to the aggregate excess of qualified research expenses over 1% of the average annual gross receipts of all members of the group for the four taxable years preceding the taxable year for which the credit is being determined.

(6) *Examples.* The following examples illustrate the provisions of this paragraph (a):

Example 1. (i) Facts. A controlled group of three corporations (all of which are calendar-year taxpayers) had qualified research expenses for the credit year 1999, qualified research expenses for the period 1984 through 1988, gross receipts for the period 1984 through 1988, and average annual gross receipts for the four years preceding the credit year as follows:

	A	B	C	Total
Credit Year Qualified Research Expenses	\$200x	\$20x	\$110x	\$330x
1984-1988 Qualified Research Expenses	\$40x	\$10x	\$100x	\$150x
1984-1988 Gross Receipts	\$1,000x	\$350x	\$150x	\$1500x
Average Annual Gross Receipts for 4 years preceding Credit Year	\$1,200x	\$200x	\$300x	\$1700x

(ii) *Computation of the group credit.* (A) The group research credit is computed as if the three corporations are one taxpayer. The research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount.

(B) The group's base amount equals the greater of fifty percent of the group's credit year qualified research expenses (the minimum base amount); or, the group's fixed-base percentage times the group's average annual gross receipts for the four taxable years preceding the credit year. The group's fixed-

base percentage is the ratio that the group's aggregate qualified research expenses for the taxable years beginning after December 31, 1983, and before January 1, 1989 bear to its aggregate gross receipts for the same period. Therefore, the group's fixed-base percentage is 150x/1500x or 10% and the group's base amount is \$170x, the greater of 50% of \$330 or 10% of \$1,700x.

(C) The group's research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount. That is 20% of (\$330 - \$170x) or

\$32x.

(iii) *Allocation of the group credit.* The group research credit of \$32x is allocated to the members of the group based on the ratio that the member's increase in its qualified research expenses over the member's base amount bears to the sum of the member increases in qualified research expenses over their base amounts. The member's base amount is computed by multiplying the group fixed-base percentage of 10% by the member's average annual gross receipts for the four preceding tax years. The \$32x credit is allocated as follows:

Member	Credit Year Qualified Research Expenses	Member Base Amount	Increase	Ratio	Credit
A	\$200x	\$120x	\$80x	80/160	\$16x
B	\$20x	\$20x		0	
C	\$110x	\$30x	\$80x	80/160	\$16x

Example 2. (i) Facts. The facts are the same as in *Example 1* except that A had no qualified research expenses during the credit year. The fol-

lowing table shows the group's qualified research expenses for the credit year, qualified research expenses for the period 1984 through 1988, gross re-

ceipts for the period 1984 through 1988, and average annual gross receipts for the four years preceding the credit year:

	A	B	C	Total
Credit Year Qualified Research Expenses	0	\$20x	\$110x	\$130x
1984-1988 Qualified Research Expenses	\$40x	\$10x	\$100x	\$150x
1984-1988 Gross Receipts	\$1,000x	\$350x	\$150x	\$1500x
Average Annual Gross Receipts for 4 years preceding Credit Year	\$1,200x	\$200x	\$300x	\$1700x

(ii) *Computation of the group credit.* Under these facts, the controlled group's credit year qualified research expenses are less than the group's base amount of \$170x, and no credit is allowed to the group unless the group elects to use the alternative incremental research credit under section 41(c)(4).

If the group elects to use the alternative incre-

mental credit under section 41(c)(4), the group is allowed a credit equal to $.0165(\$25.5x - \$17x) + .022(\$34x - \$25.5x) + .0275(\$130x - \$34x)$ or \$2.96725x.

(iii) *Allocation of the group credit.* Assuming that the group elects to use the alternative incremental research credit under section 41(c)(4), the group research credit of \$2.96725x is allocated to

the members of the group based on the ratio that the member's qualified research expenses over one percent of the member's average annual gross receipts for the four preceding years bears to the sum of the member increases in qualified research expenses over one percent of their average annual gross receipts for the four preceding years. The \$2.96725x credit is allocated as follows:

Member	Credit Year Qualified Research Expenses	1 % of Member Average Annual Gross Receipts for 4 Preceding Tax Years	Increase	Ratio	Credit
A	\$0	\$12x	0	0	
B	\$20x	\$2x	\$18x	18/125	\$.427284x
C	\$110x	\$3x	\$107x	107/125	\$2.539966x

Example 3. (i) *Facts.* A controlled group of three corporations (all of which are calendar-year taxpayers) had qualified research expenses for the credit

year 1999, qualified research expenses for the period 1984 through 1988, gross receipts for the period 1984 through 1988, and average annual gross re-

ceipts for the four years preceding the credit year as follows:

	A	B	C ¹	Total
Credit Year Qualified Research Expenses	\$200x	\$20x	\$50x	\$270x
1984-1988 Qualified Research Expenses	\$55x	\$15x	0	\$70x
1984-1988 Gross Receipts	\$1000x	\$400x	0	\$1400x
Average Annual Gross Receipts for 4 years preceding Credit Year	\$1200x	\$200x	0	\$1400x

¹C began business in 1999.

(ii) *Computation of the group credit.* (A) The group research credit is computed as if the three corporations are one taxpayer. The research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount.

(B) The group's base amount equals the greater of: fifty percent of the group's credit year qualified research expenses (the minimum base amount), or, the group's fixed-base percentage times the group's average annual gross receipts for the four taxable

years preceding the credit year. The group's fixed-base percentage is the ratio that the group's aggregate qualified research expenses for the taxable years beginning after December 31, 1983, and before January 1, 1989 bear to its aggregate gross receipts for the same period. Therefore, the group's fixed-base percentage is $70x/1400x$ or 5% and the group's base amount is \$135x, the greater of 50% of \$270x or 5% of \$1,400x.

(C) The group's research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount. That is 20% of $(\$270x - \$135x)$ or \$27x.

(iii) *Allocation of the group credit.* The group research credit of \$27x is allocated to the members of the group based on the ratio that the member's increase in its qualified research expenses over the member's base amount bears to the sum of the member increases in qualified research expenses over their base amounts. The member's base amount is computed by multiplying the group fixed-base percentage of 5% by the member's average annual gross receipts for the four preceding tax years. The \$27x credit is allocated as follows:

Member	Credit Year Qualified Research Expenses	Member Base Amount	Increase	Ratio	Credit
A	\$200x	\$60x	\$140x	14/20	\$18.9x
B	\$20x	\$10x	\$10x	1/20	\$1.35x
C	\$50x	0	\$50x	5/20	\$6.75x

Example 4. (i) *Facts.* The facts are the same as in Example 3 except that C began business in 1989. A, B, and C had qualified research expenses for the

credit year 1999, qualified research expenses for the period 1984 through 1988, gross receipts for the period 1984 through 1988, and average annual gross

receipts for the four years preceding the credit year as follows:

	A	B	C	Total
Credit Year Qualified Research Expenses	\$200x	\$20x	\$50x	\$270x
1984-1988 Qualified Research Expenses	\$55x	\$15x	0	\$70x
1984-1988 Gross Receipts	\$1,000x	\$400x	0	\$1,400x
Average Annual Gross Receipts for 4 years preceding Credit Year	\$1,200x	\$200x	\$1,000x	\$2,400x

(ii) *Computation of the group credit.* (A) The group research credit is computed as if the three corporations are one taxpayer. The research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount.

(B) The group's base amount equals the greater of: fifty percent of the group's credit year qualified research expenses (the minimum base amount), or, the group's fixed-base percentage times the group's average annual gross receipts for the four taxable years preceding the credit year. The group's fixed-

base percentage is the ratio that the group's aggregate qualified research expenses for the taxable years beginning after December 31, 1983, and before January 1, 1989 bear to its aggregate gross receipts for the same period. Therefore, the group's fixed-base percentage is $70x/1400x$ or 5% and the group's base amount is $\$135x$, the greater of 50% of $\$270x$ or 5% of $\$2,400x$.

(C) The group's research credit is equal to 20 percent of the excess of the group's aggregate credit year qualified research expenses over the group's base amount. That is 20% of $(\$270x - \$135x)$ or $\$27x$.

(iii) *Allocation of the group credit.* The group research credit of $\$27x$ is allocated to the members of the group based on the ratio that the member's increase in its qualified research expenses over the member's base amount bears to the sum of the member increases in qualified research expenses over their base amounts. The member's base amount is computed by multiplying the group fixed-base percentage of 5% by the member's average annual gross receipts for the four preceding tax years. The $\$27x$ credit is allocated as follows:

Member	Credit Year Qualified Research Expenses	Member Base Amount	Change	Ratio	Credit
A	\$200x	\$60x	\$140x	14/15	\$25.2x
B	\$20x	\$10x	\$10x	1/15	\$1.8x
C	\$50x	50x	0	0	0

(b) *For taxable years beginning before January 1, 1990.* For taxable years beginning before January 1, 1990, see § 1.41-8 in effect prior to December 30, 1999 as contained in 26 CFR part 1 revised April 1, 1999.

(c) *Tax accounting periods used—(1) In general.* The credit allowable to a member of a controlled group of corporations or of a group of trades or businesses under common control is that member's share of the aggregate credit computed as of the end of such member's taxable year. In computing the aggregate credit in the case of a group whose members have different taxable years, a member shall generally treat the taxable year of another member that ends with or within the credit year of the computing member as the credit year of that other member. In computing the aggregate base amount, the gross receipts taken into account with respect to another member shall include that other member's gross receipts for the four taxable years of that other member preceding the credit year of that other member.

* * * * *

John M. Dalrymple,
Acting Deputy Commissioner
of Internal Revenue.