

R&D Expenses and Contract Research

By Robert W. Wood • Wood & Porter • San Francisco

A recent Technical Advice Memorandum, TAM200811020 (Dec. 3, 2007), has determined that contract research expenses paid by a taxpayer in carrying on its trade or business were qualified research expenses under Code Sec. 41(b)(1). Fans of the R&D credit are no doubt smarting that the credit—which can offer a whopping 20-percent credit of the excess of qualified research expenses for the year over a base amount—applied to tax years before 2008. It is by no means clear that this credit will come back.

It was always true that in-house research was preferred in the law. Contract research could qualify for the credit, but not if the product or result of the research is intended to be transferred to another in return for license or royalty payments, where the

taxpayer does not use the product of the research in its own trade or business. [See Code Sec. 41(b); Reg. §1.41-2(a)(1).]

What makes this TAM notable is precisely that this taxpayer was engaged in carrying on a trade or business involving licensing its research results to others. Licensing *was* its trade or business. After evaluating the legislative history to the research credit, and reviewing the pertinent regulations, the TAM finds this to be a *bona fide* business operation that involved the licensing of the research results. It clearly helped the IRS to reach this happy result that this taxpayer not only licensed the results of its research, but also used the results of that research in continued research and development of new inventions.

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