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Robert W. McGee

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In 1981, concerned about the decline of the nation's research and development activities and the reluctance of many businesses to significantly expand their research investment absent tax incentives, Congress enacted a tax credit for increased research and experimental expenditures. The credit is equal to twenty-five percent of the amount by which research expenses for the taxable year exceed the research expenses for the base year. Since the writing of this Article, I.R.C. § 44F was redesignated as I.R.C. § 30 by the Tax Reform Act of 1984, Pub. L. No. 98-369, § 471(c)(1), 98 Stat. 494. See also S. REP. NO. 144, 97th Cong., 1st Sess. 77, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 105, 182.
expenses incurred during an earlier base period. As the law now stands, the research credit can be taken for research expenditures incurred between June 30, 1981 and January 1, 1986.

I. QUALIFYING RESEARCH

Only qualified research is eligible for the research credit. In general, it must be the kind of research for which taxpayers are allowed to deduct or amortize their expenses under other provisions of the tax law. That is, the credit applies only to research and development in the experimental or laboratory sense.

The credit, however, can only be taken for research that is performed or paid for in carrying on a trade or business. Such activities include developing or improving a product, a formula, an invention, a

4. I.R.C. § 44F(b) (1982); Treas. Reg. § 1.174-2(a)(1) (1957). On January 21, 1983, proposed regulations were issued that, if adopted, would place more stringent restrictions on software than on other types of research and experimental expenditures. As a result of a large public outcry, the proposed regulations have been withdrawn for further drafting.
plant process, an experimental or pilot model, or something similar. The process of obtaining a patent, including making and protecting a patent application, is also treated as "research" that qualifies for the credit. Acquiring someone else's patent, production, or process, however, does not qualify as research and thus is ineligible for the credit.6

The credit cannot be taken for any of the following activities:7
(1) research performed outside the United States;
(2) research in the social sciences or humanities;
(3) research funded or financed by another party whether under a contract or grant;
(4) quality control testing or inspection;
(5) market and consumer research;
(6) advertising or promotion expenses;
(7) management studies or efficiency surveys; and
(8) research to find and evaluate mineral deposits, including natural gas and oil.

II. RESEARCH EXPENSES

Not all research expenses can be included in the computation of the credit. Instead, the credit applies only to those expenditures which constitute any of the following: wages of the employees performing the research;8 the cost of supplies used in the research;9 payments to others (such as lease payments) for the right to use personal property in the research;10 contract research expenses (costs of having nonemployees perform the research);11 and "basic research" expenses.12

A. WAGES

Only wages paid to employees for actually performing research work, or for directly supervising or supporting research work, qualify for the credit. Wages paid for overhead, general and administrative services, or other work that is only indirectly connected to the research do not qualify.13 The following example illustrates this dichotomy: A company employs five staff programmer/analysts who work on research and development-type projects. A senior programmer/analyst supervises their work, and a secretary types their reports and letters, and an-

9. Id. § 44F(b)(2)(ii).
10. Id. § 44F(b)(2)(iii).
11. Id. § 44F(b)(3).
12. Id. § 44F(e)(1).
swers the telephone. The wages of all seven employees can be included when computing the credit. No part, however, of the wages paid to the employees who prepare salary checks for the staff, arrange loans for the research, or clean the building each day can be used to compute the credit.

In general, for purposes of computing the research credit, "wages" has the same meaning as it does for income tax withholding. Any wages used to compute the targeted jobs credit, however, cannot also be used in computing the research credit.

If an employee performs some work that qualifies for the credit and some that does not, the employee's wages must be divided between the two. Only the portion of the wages paid for the performance, supervision, or support of qualified research can be included when computing the credit. If at least eighty percent of the employee's work during the tax year would qualify, however, then one hundred percent of the employee's wages can be used when computing the credit. For example, if an employee works four days of each five day workweek performing research and one day performing general office work, all of the employee's wages can be treated as research expenses since four-fifths or eighty percent of this employee's time is spent performing research. If, however, the employee was engaged in research activities for only three days, or sixty percent of the time, only sixty percent of the employee's wages could be treated as research expenses.

A sole proprietor can treat earned income from the business as wages. Therefore, if a part of the work performed in the business is research work, or the direct supervision or support of research work, part of the earned income can be included as a research expense when computing the credit. The earned income must be divided between work that qualifies for the credit and work that does not qualify, just as an employee's wages would be divided.

The same rule applies to partners who have at least a ten percent interest in the partnership. If such a partner is involved in the research work, the partnership can include a part of the partner's earned income from the partnership when computing the credit.

**B. Supplies**

When computing the total amount of expenses available for the

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14. *Id.* § 44F(b)(2)(D)(i).
15. *Id.* § 44F(b)(2)(D)(iii).
17. *Id.* § 1.44F-2(d)(2).
Credit, the cost of any supplies used while conducting qualified research can be included.\textsuperscript{20} All tangible property used in the research is considered supplies, except land or improvements to land and depreciable property.\textsuperscript{21} Depreciable property can never be treated as supplies. This is true whether a depreciation deduction or an expense deduction can be taken on the property.

\section*{C. Payments to Others}

Research expenses include payments made to others for the right to use personal property in research.\textsuperscript{22} Research expenses, however, do not include payments made to others after March 31, 1982, for the right to use personal property in the research, to the extent that payments are received for the right to use substantially identical personal property.\textsuperscript{23} For example, if a company performing research purchased a microscope, leased this microscope to another corporation, and then leased the microscope back from the second corporation, the research corporation could not include the rental payments made to the second corporation as research expenses. Additionally, payments for the rental of real property and intercompany charges cannot be included as research expenses.

\section*{D. Contract Research Expenses}

Only sixty-five percent of contract research expenses can be included in the computation of the credit.\textsuperscript{24} A contract research expense is one that is paid or incurred by the taxpayer to any person who is not an employee for qualified research. Thus, contract research is normally paid to some person or entity outside the company and can be distinguished from "in house" research.

If a payment is made for qualified research that will be performed after the end of the tax year, the payment must be treated as having been made during the year in which the research is actually performed.\textsuperscript{25} For example, if in December, 1983, a calendar year corporation paid a research firm $200,000 to perform qualified research that would be performed in 1984, none of the $200,000 can be included as a research expense for the 1983 tax year. However, $130,000 (sixty-five

\begin{footnotes}
\footnotetext[20]{Id. § 1.44F-2(b)(1).}
\footnotetext[21]{I.R.C. § 44F(b)(2)(C) (1982).}
\footnotetext[22]{Id. § 44F(b)(2)(A)(iii).}
\footnotetext[24]{I.R.C. § 44F(b)(3)(A) (1982).}
\footnotetext[25]{Id. § 44F(b)(3)(B).}
\end{footnotes}
percent of $200,000) qualifies as a research expense for the 1984 tax year.

E. Basic Research

A corporation can treat as contract research expenses certain payments made for "basic research." "Basic research" means any original investigation to advance scientific knowledge not having a specific commercial objective. Basic research done outside the United States and research done in the social sciences or humanities are not included. Thus, in addition to any other expenses it incurs for qualified research, a corporation can include sixty-five percent of certain amounts it expends for basic research when computing the research credit.

Only corporations can include expenses incurred for basic research when computing the credit. Individuals and unincorporated businesses are not permitted to take a credit for any basic research expenditures they incur. In addition, basic research expenses cannot be included when computing the total amount of research expenditures with respect to subchapter S corporations, personal holding companies, or corporations in which the principal business is the performance of services.

In order for a basic research expenditure to qualify for the credit, the taxpayer must, prior to the performance of the basic research, enter into a written research agreement with a qualifying organization. Three kinds of organizations qualify:

1. A public or non-profit institution of higher education, such as a college, university, or vocational school;
2. A tax-exempt organization, other than a private foundation, that is organized and operated primarily to carry out scientific research; and
3. A fund that chooses to qualify.

In order for a fund to qualify as an organization that may receive contract research payments from a corporation, the fund must meet all four of the following requirements:

1. It must be organized and operated exclusively to make grants for basic research to public or nonprofit institutions of higher education, such as, colleges, universities, vocational schools, and similar institutions;

26. Id. § 44F(e)(3).
27. Id.
28. Id. § 44F(e)(1).
29. Id. § 170(e)(4)(D).
30. Id. § 44F(e)(2)(A).
31. Id. § 44F(e)(2)(B).
32. Id. § 44F(e)(4).
33. Id.
(2) it must be tax exempt;
(3) it cannot be a private foundation; and
(4) it must be established and maintained by a tax exempt organization which was formed prior to July 10, 1981, but which is not classified as a private foundation.

If a fund meets all four of these requirements, it can choose to be a qualifying organization.\(^{34}\) An election to be treated as a qualified organization may only be revoked with the consent of the Secretary of the Treasury.\(^{35}\)

III. COMPUTING THE CREDIT

The amount of credit allowable for a tax year is twenty-five percent of the amount by which the qualified research expenses for the year exceed the average qualified research expenses for an earlier base period. Consequently, if the qualified research expenses for the year are not more than the average qualified research expenses during the base period, the taxpayer will not be eligible for a credit.\(^{36}\) Generally, the base period is the three taxable years immediately preceding the year for which the credit is being computed.\(^{37}\) For example, if in the previous three years, a corporation has incurred qualified research expenses of $3,000,000, $4,000,000 and $5,300,000, and the qualified research expenses

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34. Treas. Reg. § 1.44F-5(f) (proposed Jan. 21, 1983). A fund can exercise its option to be treated as a qualified organization by sending a statement to the Internal Revenue Service center where it files its annual return. The statement must explicitly state that the choice is being made under I.R.C. § 44F(e)(4). The statement must be signed by a person authorized to act for the organization and must provide all information necessary to establish that the organization can make the choice. Consequently, the statement must contain the following information:

1. the name, address, and taxpayer identification number of the fund;
2. the name, address, and taxpayer identification number of the organization that set up the fund; and
3. the date the choice becomes effective.

For funds that make the choice before February 1, 1982, the effective date cannot be before July 1, 1981. For funds that make the choice after January 31, 1982, the effective date cannot be before the date the choice is made.

35. I.R.C. § 44F(e)(4)(C)(ii) (1982). In order to obtain this consent, the fund should send an application to revoke its choice to the Internal Revenue Service center where it had originally sent its application statement. This revocation application must contain the following information:

1. the names, addresses, and taxpayer identification numbers of all parties identified in the original choice;
2. an indication that the choice was made under I.R.C. § 44F(e)(4);
3. a statement of what the choice covered; and
4. an explanation of why the change is desired.

36. Id. § 44F(a).

37. Id. § 44F(c)(2)(A).
for the current year total $5,600,000, then the allowable research credit for the current year is $375,000, determined as follows:

1st Year $ 3,000,000  
2nd Year 4,000,000  
3rd Year 5,300,000  
$12,300,000  

Base period average $ 4,100,000  

4th Year $ 5,600,000  
Less: Base period average 4,100,000  
Amount eligible for research credit $ 1,500,000  
Research credit (25%) $ 375,000  

Only those expenditures that would qualify for the credit if they were spent in the current tax year can be used to compute research expenditures for the base period. Again, these expenses include wages, supplies, payments to others, sixty-five percent of contract research expenses, and for certain corporations, sixty-five percent of the payments made for basic research.

The base period research expenses, however, cannot be less than fifty percent of the research expenses for the current year. If they are less than fifty percent, an amount that is at least fifty percent must be substituted as the base period expenses. In other words, the credit cannot be computed on more than one-half of the research expenses that qualify for the credit each year. This limit applies every year, even if there were no research expenses during the base period. In addition, the limit applies to all businesses, including new ones. For example, assume that a calendar year corporation commences business on January 1, 1982. It has $30,000 in research expenses that qualify for the credit in 1982, $30,000 in 1983 and $300,000 in 1984. The base period for computing the credit for 1984 is the preceding three years, 1981, 1982 and 1983. The actual base period research expenses are $20,000, the average of the expenses for 1981 ($0), 1982 ($30,000), and 1983 ($300,000). Because $20,000 is less than fifty percent of the research expenses for 1984 ($300,000), the base period research expense figure used to compute the credit must be at least $150,000 (fifty percent of $300,000). In other words, the credit can be computed on no more than half of the $300,000. Thus, the maximum credit for 1984 will be $37,500 (twenty-five percent of $150,000).

38. Id. § 44F(c)(3).
For tax years of less than twelve months, the qualified research expenses for that year are determined on an annual basis.\textsuperscript{39}

IV. USING THE CREDIT

A. INDIVIDUAL BUSINESSES

The credit is used to reduce, dollar for dollar, the amount of tax that must be paid. There are limits, however, on the amount of the credit that can be claimed each year. If a portion of the credit cannot be used in the year earned, it can generally be carried back or forward and used to reduce taxes in previous or future years.

The amount of research credit taken in any tax year cannot exceed the income tax liability for that year. For the purpose of computing this limitation, however, none of the following taxes should be included: \textsuperscript{40}

1. alternative minimum tax;
2. corporate minimum tax;
3. ten percent tax on premature distributions to owner-employees;
4. five percent tax on premature distributions under annuity contracts;
5. tax on lump-sum distributions;
6. additional tax on income from certain retirement accounts;
7. accumulated earnings tax;
8. personal holding company tax;
9. tax on certain capital gains of S corporations; or
10. any additional tax imposed as a result of recoveries of foreign expropriation losses.

Additionally, before using the research credit to reduce tax liability, the following credits must first be used: \textsuperscript{41}

1. foreign tax credit;
2. credit for the elderly;
3. investment credit;
4. WIN credit;
5. credit for political contributions;
6. credit for child and dependent care expenses;
7. jobs credit;
8. residential energy credit;
9. nonconventional source fuel credit;
10. credit for alcohol used as fuel; and
11. possessions corporation tax credit.

After the above-mentioned credits have been used to reduce the

\textsuperscript{39} Id. § 44F(f)(4).
\textsuperscript{40} Treas. Reg. § 1.44F-4 (proposed Jan. 21, 1983).
\textsuperscript{41} I.R.C. § 44F(g)(1) (1982).
tax, the research credit may then be used. The credit cannot, however, be used to reduce the remaining tax to less than zero.

A special limit applies if the credit that was earned by the business is taken on an individual's tax return. This limitation occurs if the taxpayer is:

1. an owner of an interest in an unincorporated trade or business;
2. a partner in a partnership;
3. a shareholder in a subchapter S corporation; or
4. a beneficiary of an estate or trust.

Partnerships, subchapter S corporations, estates, and trusts pass through the credits they earn to their partners, shareholders, and beneficiaries. In order to insure that these individuals do not unduly benefit from the new credit, the new law established the passthrough limitations.

To compute the limitation, the portion of the income tax liability that is due with respect to the taxable income arising from the business that earned the credit is first determined. This portion represents the limit on the amount of credit that may be taken. This amount is then compared to the amount that was computed to be the tax liability limitation. The smaller of the two is the maximum amount of research credit that can be taken for the year.

If any portion of the research credit cannot be used because of any of these limitations, the part not used in the current year can be carried back three years or forward fifteen years. The credit must first be carried back to the earliest of the last three tax years, even if the research credit was not in effect that year. If the carryover amount is not used up in that year, the remainder is then carried to the second earliest tax year, and so on until either it is used up or is carried forward to the fifteenth year.

If, because of a carryover or carryback, research credits from more than one year are used in the same year, they cannot be used in random order. Instead, credit earned in the current year must be used first. After that, credits may be carried to that year, beginning with credits from the earliest year.

If the research credit is carried back, the taxpayer can obtain a refund of the earlier year's tax by filing an amended return. Either form 1040X, Amended U.S. Individual Income Tax Return, or Form 1120X, Amended U.S. Corporation Income Tax Return, can be used, depending on whether the original return for the earlier year was a Form 1040 or 1120. The amended return must be filed within three years af-

42. See id. § 44F(g)(1)(B).
43. Id. § 44F(g)(2).
44. Id. § 301.6402-3(a).
ter the due date (including extensions) of the return for the year the credit was earned. For example, a calendar year individual should file an amended return by April 15, 1987 to obtain a refund of 1980 taxes because of a research credit carryback from 1983.

The time for filing an amended return varies depending on whether the research credit carryback is caused by the carryback of a net operating loss, capital loss, investment credit, or jobs credit. If one of these causes the carryback of the research credit, then the taxpayer has three years from the due date, including extensions, of the tax return for the year in which the net operating loss, capital loss, investment credit, or jobs credit occurred.

An individual taxpayer may be able to obtain a quick refund of an earlier year's tax payment by filing Form 1045, Application for Tentative Refund. Corporations can use Form 1139, Corporation Application for Tentative Refund. The form must be filed within twelve months after the end of the tax year in which the credit was earned. For a research credit carryback caused by a net operating loss, capital loss, investment credit, or jobs credit that is carried back from a later tax year to the year the research credit was earned, the application for a quick refund must be filed within twelve months of the end of the later tax year.

B. BUSINESS UNDER COMMON CONTROL

Generally, the research credit for a group of trades or businesses under common control is computed as if the group were a single business. Thus, one credit is computed for the entire group and then divided among the members. The division is based on each member's proportionate share of the total increase in the group's research expenses for the tax year.

When determining whether a trade or business is under common control for the purpose of the research credit, the same common control (fifty percent) test is used as that used for computing the targeted jobs tax credit. A business can be under common control with one or more other businesses whether the second business is a corporation, a partnership, a sole proprietorship, an estate, or a trust.

If the trade or business is under common control, the following

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47. Treas. Reg. § 1.44F-6(a)(4)(iii) (proposed Jan. 21, 1983).
48. Id. § 1.44F-6(a).
steps are taken to compute the research credit:49
(1) Total the research expenses for the tax year for all members of the
group.
(2) Add the base period research expenses for all members of the
group.
(3) Subtract (2) from (1). The result is the increase in the entire
group's research expenses.
(4) Compute the credit for the group. This will equal twenty-five per-
cent of the difference in step (3). If, however, the amount from step (2)
is less than fifty percent of the amount from step (1), the group's credits
will equal twenty-five percent of an amount equal to one half of (1).
(5) Divide the group credit from step (4) among the members of the
group, based on each member's share of the amount from step (3).

For example, assume Alpha Company has two subsidiaries, Beta
Enterprises and Delta Manufacturing. The following table shows the
base period research expenses and the research expenses that qualify
for the credit during the current tax year for each company.

<table>
<thead>
<tr>
<th>Company</th>
<th>Base period average</th>
<th>Current year expenses</th>
<th>Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha</td>
<td>$ 60,000</td>
<td>$120,000</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>Beta</td>
<td>30,000</td>
<td>20,000</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Delta</td>
<td>40,000</td>
<td>70,000</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>$130,000</td>
<td>$210,000</td>
<td>$ 80,000</td>
</tr>
</tbody>
</table>

The group's total increase in research expenses is $80,000 ($60,000
increase by Alpha plus $30,000 increase by Delta less a $10,000 decrease
by Beta). Therefore, the group's allowable credit is $20,000 (twenty-five
percent of $80,000). Only Alpha and Delta actually increased their re-
search expenses, so all of the group's credit is divided between those
two. Because Beta's expenses did not increase, it cannot share in the
credit. The individual increases by Alpha and Delta total $90,000; there-
fore Alpha is entitled to 60/90 of the total credit ($13,333) and Delta is
entitled to 30/90 ($6,667).

C. ACQUISITIONS AND DISPOSITIONS

If, after June 30, 1980, a business or part of a business is acquired or
disposed of, special rules are used to determine the research credit.
These rules do not apply if there is only a transfer of some of the assets
used in a trade or business. More specifically, in order for these special

49. Id. § 1.44F-6(a)(4).
rules to apply, the part of the business that is transferred must be large enough to be operated as a viable business.

If a business or portion of a business is acquired, then for the purpose of computing the credit for a tax year ending after the date of acquisition, the amount of research expenses for the period before the acquisition must be increased to include the previous owner's research expenses that are attributable to the part of the acquired business. This adjustment is made when computing both the base period research expenses and the research expenses for the current year.50

If a portion of the trade or business is disposed of, then for purposes of computing the credit for a tax year ending after the date of disposition, the amount counted as research expenses for the period before the transfer must be decreased by the portion of the research expenses that are attributable to the disposed business segment.51 This decrease by the previous owner can be made only if the new owner is given the information needed to make the necessary increase in its base period and current research expenses as discussed above.

If this decrease is made and the new owner is reimbursed for research performed for the previous owner within three tax years following the year of disposition, some or all of this decrease must be added back. A taxpayer may increase the qualified research expenses for the base period for the tax year when the reimbursement is made by adding back the smaller of the following amounts:
(1) the amount of the original decrease made for the base period; or
(2) the amount of the reimbursement multiplied by the number of years in the base period.52

V. APPLICATION OF THE RESEARCH CREDIT TO COMPUTER SOFTWARE

On January 21, 1983, the Treasury Department issued a proposed regulation53 that, if adopted, would provide guidance for the implementation of section 44F by more clearly defining research and experimental expenditures.54 As drafted, the proposed regulation sets forth separate standards, stricter than those for other research activities, that computer software55 development expenditures must meet in order to

51. Id. § 44F(f)(3)(B).
53. Treas. Reg. § 1.174-2 (proposed Jan. 21, 1983). Due to public outcry, this regulation has been withdrawn for further drafting.
54. In general, the proposed regulations under § 44 provide that the term "qualified research" for the purposes of § 44F means research expenditures within the meaning of § 174. See Treas. Reg. § 1.44F-4(a) (proposed Jan. 21, 1983).
55. The Service describes computer software in Revenue Procedure 69-21 as:
qualify as qualified research costs. The proposed regulation provides:

Generally, the costs of developing computer software are not research or experimental expenditures within the meaning of section 174. However, the term “research or experimental expenditures,” as used in section 174, includes the programming costs paid or incurred for new or significantly improved computer software. The term does not include costs paid or incurred for the development of software the operational feasibility of which is not seriously in doubt. The costs of modifying previously developed computer software programs, such as the costs of adapting an existing program to specific customer needs, or the costs of translating an existing program for use with other equipment do not constitute research or experimental expenditures. Whether software is “new or significantly improved” will be determined with regard to the computer program itself rather than the end use of the program. For example, the costs of developing a program to perform economic analysis which involves only standard or well known programming techniques are not research or experimental expenditures even if the economic principles embodied in the program are novel. However, if the programming itself involves a significant risk that it cannot be written, the costs of developing the program are research or experimental expenditures regardless of whether the economic principles or formulas embodied in the program are novel.56

Thus, under the proposed regulation, the computer software program must be new or significantly improved and have its operational feasibility seriously in doubt in order to qualify as a research or experimental expenditure. The general requirement, however, for most other expenditures to qualify as research or experimental is that they must be incurred in connection with a taxpayer's trade or business and represent research and development costs in the experimental or laboratory sense.57 Under the proposed regulations, this term includes all costs incident to the development or improvement of an experimental or pilot model, a plant process, a product, a formula, an invention, or a similar kind of property.58 Consequently, under these provisions a normal research product is not required to be “new or significantly improved.” Nor does the operational feasibility of the project enter into the determination as to whether the expenditures will qualify as research or experimental.

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57. Id. § 1.174-2(a)(1).
58. Id.
By drafting a regulation that sets a separate and stricter standard for software development than for other research activities, the Treasury has contradicted the intent of Congress with respect to its proposed treatment of software expenditures. The Internal Revenue Service has stated that the proposed regulations under section 174\textsuperscript{59} are in accord with congressional intent, as that intent was interpreted by the Staff of the Joint Committee on Taxation.\textsuperscript{60} The problem is that the Staff of the Joint Committee on Taxation did not correctly interpret the true intent of Congress with respect to the definition of qualified research.

The Staff explanation of the Economic Recovery Tax Act of 1981 (ERTA)\textsuperscript{61} was drawn from two principal sources: the House Ways and Means Committee Report\textsuperscript{62} and the Senate Finance Committee Report.\textsuperscript{63} The House Ways and Means Committee definition of qualified research was originally derived from the Financial Accounting Standards Board's definition of "research and development."\textsuperscript{64} This House Ways and Means Committee definition, however, was never adopted by the House of Representatives. Instead, the House of Representatives adopted a substitute bill,\textsuperscript{65} which was adopted as H.R. 4242 in lieu of the House Ways and Means Committee reported bill. The substitute bill was virtually identical, with respect to the definition of qualified research, to the final bill adopted by the Senate, which provided that qualified research was to have the same general meaning as "research or experimental expenditures" as used in section 174. Because the Senate version was adopted, the House Ways and Means Committee's definition should not be given much weight. Reliance by the Staff of the Joint Committee on Taxation on the House Ways and Means definition and examples of qualified research was, therefore, misguided and incorrect.\textsuperscript{66} Furthermore, because the Service relied on the Staff of the

\textsuperscript{64.} See Financial Accounting Standards Bd., Statement No. 2, Accounting For Research and Development Costs § 8 (1974). This definition focused on a planned search or critical investigation to discover useful information or develop a plan for a new or significantly improved business item for use or sale by the taxpayer in a trade or business.
\textsuperscript{66.} The House Ways and Means Committee report provided that "costs of developing computer software means costs incurred in developing new or significantly improved programs or routines that cause computers to perform desired tasks (as distinguished from other software costs where the operational feasibility of the program or routine is not se-
Joint Committee on Taxation's explanation of the Act, it was also misled with respect to the definition of qualified research. The Service should have based its regulations on the more expansive Senate definition of qualified research\textsuperscript{67} rather than the more restrictive House Ways and Means Committee definition.

CONCLUSION

As proposed, Treasury Regulation section 1.174-2 does not accurately reflect the intent of Congress with respect to qualification of computer software expenditures for the research credit. The Service should look to the Senate Finance Committee Report rather than the House Ways and Means Committee Report for proper guidance and authority when redrafting the next set of proposed regulations in the computer software area. At the present time, taxpayers and tax practitioners should look to the authority under section 174 for determining whether projects qualify for the Research and Development Credit.

\textsuperscript{67} See supra text accompanying notes 4-7.