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113TH CONGRESS
2D SESSION

H. R. 4855

To amend the Internal Revenue Code of 1986 to provide an exception from the passive loss rules for investments in high technology research small business pass-thru entities.

IN THE HOUSE OF REPRESENTATIVES

JUNE 12, 2014

Mr. GERLACH (for himself, Mr. NEAL, Mr. KELLY of Pennsylvania, and Mr. KIND) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1986 to provide an exception from the passive loss rules for investments in high technology research small business pass-thru entities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXCEPTION FROM PASSIVE LOSS RULES FOR INVESTMENTS IN HIGH TECHNOLOGY RESEARCH SMALL BUSINESS PASS-THRU ENTITIES.

(a) IN GENERAL.—Subsection (c) of section 469 of the Internal Revenue Code of 1986 is amended by redesig-

nating paragraphs (4) through (7) as paragraphs (5) through (8), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) HIGH TECHNOLOGY RESEARCH ACTIVITIES.—

"(A) IN GENERAL.—The term 'passive activity' shall not include any qualified research activity of the taxpayer carried on by a high technology research small business pass-thru entity.

"(B) TREATMENT OF LOSSES AND DEDUCTIONS.—

"(i) IN GENERAL.—Losses or deductions of a taxpayer relating to qualified research activities carried on by a high technology research small business pass-thru entity shall not be treated as losses or deductions, respectively, from a passive activity except as provided in clause (ii) and subparagraph (C).

"(ii) LIMITATION.—Clause (i) shall apply to losses and deductions of a taxpayer relating to a high technology small business pass-thru entity for a taxable year only to the extent that the aggregate losses

and deductions of the taxpayer relating to qualified research activities of such entity for such taxable year do not exceed the portion of the taxpayer's adjusted basis in the taxpayer's ownership interest in such entity that is attributable to money or other property contributed—

"(I) in exchange for such ownership interest, and

"(II) specifically for use in connection with qualified research activities.

For purposes of the preceding sentence, the taxpayer's basis shall not include any portion of such basis which is attributable to an increase in a partner's share of the liabilities of a partnership that is considered under section 752(a) as a contribution of money.

"(C) TREATMENT OF CARRYOVERS.—Subparagraph (B)(i) shall not apply to the portion of any loss or deduction that is carried over under subsection (b) into a taxable year other than the taxable year in which such loss or deduction arose.

"(D) QUALIFIED RESEARCH ACTIVITY.—For purposes of this paragraph, the term 'qualified research activity' means any activity constituting qualified research (within the meaning of section 41(d)(1)(B) and taking into account paragraphs (3) and (4) of section 41(d)) which involves a process of experimentation.

"(E) HIGH TECHNOLOGY RESEARCH SMALL BUSINESS PASS-THRU ENTITY.—For purposes of this paragraph, the term 'high technology research small business pass-thru entity' means any domestic pass-thru entity for any taxable year if—

"(i) either—

"(I) more than 75 percent of the entity's expenditures (including salaries, rent and overhead) for such taxable year are paid or incurred in connection with qualified research (within the meaning of section 41(d)(1)(B), taking into account paragraphs (3) and (4) of section 41(d)) that involves a process of experimentation conducted by the entity, or

"(II) more than 50 percent of the entity's expenditures for such taxable year constitute qualified research expenses (as defined in section 41(b), but determined without regard to the phrase '65 percent of' in paragraph (3)(A) thereof),

"(ii) such entity is a small business (within the meaning of section 41(b)(3)(D)(iii), applied by substituting '250' for '500' in subclause (I) thereof), and

"(iii) at no time during the taxable year does the entity have aggregate gross assets in excess of $150,000,000.

"(F) PROVISIONS RELATED TO AGGREGATE GROSS ASSETS LIMITATION.—For purposes of this paragraph—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'aggregate gross assets' has the meaning given such term in section 1202(d)(2).

"(ii) EXCEPTION FOR CERTAIN INTANGIBLES.—Any section 197 intangible

(as defined in section 197(d) and determined without regard to section 197(e)) which is used directly in connection with the research referred to in subparagraph (E)(i) shall not be taken into account in determining aggregate gross assets.

"(iii) EXCEPTION FOR CERTAIN FOLLOW-ON INVESTMENTS.—Cash from a sale of equity interests shall not be taken into account in determining aggregate gross assets if—

"(I) the aggregate gross assets of such entity (determined immediately after such sale and without regard to this clause) do not exceed the sum of $150,000,000, plus 25 percent of the aggregate gross assets of such entity (determined immediately before such sale and without regard to this clause), and

"(II) the aggregate gross assets of such entity (determined immediately before such sale and without regard to this clause) do not exceed $150,000,000.

Sales of equity interests which are part of the same plan or arrangement, or which are carried out with the principal purpose of increasing the amount of cash to which this clause applies (determined without regard to this sentence), shall be treated as a single sale for purposes of this clause.

"(iv) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2015, the $150,000,000 amount in subparagraph (E)(iii) and subclauses (I) and (II) of clause (iii) shall each be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost of living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins determined by substituting 'calendar year 2014' for 'calendar year 1992' in subparagraph (B) thereof.

Any increase determined under the preceding sentence shall be rounded to the nearest $100,000.

"(G) CAPITAL EXPENDITURES TAKEN INTO ACCOUNT FOR EXPENDITURES TEST.—An expenditure shall not fail to be taken into account under subparagraph (E)(i) merely because such expenditure is chargeable to capital account.

"(H) PASS-THRU ENTITY.—For purposes of this paragraph, the term 'pass-thru entity' means any partnership, S corporation, or other entity identified by the Secretary as a pass-thru entity for purposes of this paragraph.

"(I) AGGREGATION RULES.—

"(i) IN GENERAL.—All persons treated as a single employer under subsection (a) or (b) of section 52, or subsection (m) or (o) of section 414, shall be treated as a single entity for purposes of subparagraphs (E) and (F)(iii).

"(ii) LIMITATION WHERE ENTITY WOULD NOT QUALIFY.—No entity shall be treated as a high technology research small business pass-thru entity unless such entity qualifies as such both with and without the application of clause (i).

"(J) ACTIVITIES NOT ENGAGED IN FOR PROFIT AND ECONOMIC SUBSTANCE RULES.—

Section 183 and the economic substance rules of section 7701(o) shall not apply to disallow the losses, deductions, and credits of a high technology research small business pass-thru entity solely as a result of losses incurred by such entity.''.

(b) MATERIAL PARTICIPATION NOT REQUIRED.—Paragraph (5) of section 469(c) of the Internal Revenue Code of 1986, as redesignated by subsection (a), is amended by striking ''and (3)'' in the heading and text and inserting '', (3), and (4)''.

(c) CERTAIN RESEARCH-RELATED DEDUCTIONS AND CREDITS OF HIGH TECHNOLOGY RESEARCH SMALL BUSINESS PASS-THRU ENTITIES ALLOWED FOR PURPOSES OF DETERMINING ALTERNATIVE MINIMUM TAX.—

(1) DEDUCTION FOR RESEARCH AND EXPERIMENTAL EXPENDITURES.—Paragraph (2) of section 56(b) of the Internal Revenue Code of 1986 is amended by adding at the end the following new subparagraph:

''(E) EXCEPTION FOR HIGH TECHNOLOGY RESEARCH SMALL BUSINESS PASS-THRU ENTITIES.—In the case of a high technology research small business pass-thru entity (as defined in section 469(c)(4)), this paragraph shall

not apply to any amount allowable as a deduction under section 174(a).''.

(2) ALLOWANCE OF CERTAIN RESEARCH-RELATED CREDITS.—Subparagraph (B) of section 38(c)(4) of such Code is amended by redesignating clauses (ii) through (ix) as clauses (iii) through (x), respectively, and by inserting after clause (i) the following new clause:

''(ii) the credits of an individual taxpayer determined under sections 41 and 48D to the extent attributable to a high technology research small business pass-thru entity (as defined in section 469(c)(4)),''.

(d) EXCEPTION TO LIMITATION ON PASS-THRU OF RESEARCH CREDIT.—Subsection (g) of section 41 of such Code is amended by adding at the end the following: ''Paragraphs (2) and (4) shall not apply with respect to any high technology research small business pass-thru entity (as defined in section 469(c)(4)).''.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to losses and credits arising in taxable years beginning on or after the date of the enactment of this Act.

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