

**§ 1.41-3A**

**26 CFR Ch. I (4-1-13 Edition)**

- (2) Research in the social sciences or humanities.
- (f) Procedure for making an election to be treated as a qualified fund.

[T.D. 8930, 66 FR 295, Jan. 3, 2001]

**§ 1.41-3A Base period research expense.**

(a) *Number of years in base period.* The term “base period” generally means the 3 taxable years immediately preceding the year for which a credit is being determined (“determination year”). However, if the first taxable year of the taxpayer ending after June 30, 1981, ends in 1981 or 1982, then with respect to that taxable year the term “base period” means the immediately preceding taxable year. If the second taxable year of the taxpayer ending after June 30, 1981, ends in 1982 or 1983, then with respect to that taxable year the term “base period” means the 2 immediately preceding taxable years.

(b) *New taxpayers.* If, with respect to any determination year, the taxpayer has not been in existence for the number of preceding taxable years that are included under paragraph (a) of this section in the base period for that year, then for purposes of paragraph (c)(1) of this section (relating to the determination of average qualified research expenses during the base period), the taxpayer shall be treated as—

(1) Having been in existence for that number of additional 12-month taxable years that is necessary to complete the base period specified in paragraph (a) of this section, and

(2) Having had qualified research expenses of zero in each of those additional years.

(c) *Definition of base period research expenses.* For any determination year, the term “base period research expenses” means the greater of—

(1) The average qualified research expenses for taxable years during the base period, or

(2) Fifty percent of the qualified research expenses for the determination year.

(d) *Special rules for short taxable years—*(1) *Short determination year.* If the determination year for which a research credit is being taken is a short taxable year, the amount taken into account under paragraph (c)(1) of this

section shall be modified by multiplying that amount by the number of months in the short taxable year and dividing the result by 12.

(2) *Short base period year.* For purposes of paragraph (c)(1) of this section, if a year in the base period is a short taxable year, the qualified research expenses paid or incurred in the short taxable year are deemed to be equal to the qualified research expenses actually paid or incurred in that year multiplied by 12 and divided by the number of months in that year.

(3) *Years overlapping the effective dates of section 41 (section 44F)—*(1) *Determination years.* If a determination year includes months before July 1981, the determination year is deemed to be a short taxable year including only the months after June 1981. Accordingly, paragraph (d)(1) of this section is applied for purposes of determining the base period expenses for such year. See section 221(d)(2) of the Economic Recovery Tax Act of 1981.

(ii) *Base period years.* No adjustment is required in the case of a base period year merely because it overlaps June 30, 1981.

(4) *Number of months in a short taxable year.* The number of months in a short taxable year is equal to the number of whole calendar months contained in the year plus fractions for any partially included months. The fraction for a partially included month is equal to the number of days in the month that are included in the short taxable year divided by the total number of days in that month. Thus, if a short taxable year begins on January 1, 1982, and ends on June 9, 1982, it consists of 5 and 9/30 months.

(e) *Examples.* The following examples illustrate the application of this section.

*Example 1.* X Corp., an accrual-method taxpayer using the calendar year as its taxable year, is organized and begins carrying on a trade or business during 1979 and subsequently incurs qualified research expenses as follows:

1979 .....	\$10x
1980 .....	150x
1/1/81-6/30/81 .....	90x
7/1/81-12/31/81 .....	110x
1982 .....	250x
1983 .....	450x

(i) *Determination year 1981.* For determination year 1981, the base period consists of the immediately preceding taxable year, calendar year 1980. Because the determination year includes months before July 1981, paragraph (d)(3)(i) of this section requires that the determination year be treated as a short taxable year. Thus, for purposes of paragraph (c)(1) of this section, as modified by paragraph (d)(1) of this section, the average qualified research expenses for taxable years during the base period are \$75x (\$150x, the average qualified research expenses for the base period, multiplied by 6, the number of months in the determination year after June 30, 1981, and divided by 12). Because this amount is greater than the amount determined under paragraph (c)(2) of this section (50 percent of the determination year's qualified research expense of \$110x, or \$55x), the amount of base period research expenses is \$75x. The credit for determination year 1981 is equal to 25 percent of the excess of \$110x (the qualified research expenditures incurred during the determination year including only expenditures accrued on or after July 1, 1981, through the end of the determination year) over \$75x (the base period research expenses).

(ii) *Determination year 1982.* For determination year 1982, the base period consists of the 2 immediately preceding taxable years, 1980 and 1981. The amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is \$175x ( $(\$150x + \$90x + \$110x) / 2$ ). This amount is greater than the amount determined under paragraph (c)(2) of this section, (50 percent of \$250x, or \$125x). Accordingly, the amount of base period research expenses is \$175x. The credit for determination year 1982 is equal to 25 percent of the excess of \$250x (the qualified research expenses incurred during the determination year) over \$175x (the base period research expenses).

(iii) *Determination year 1983.* For determination year 1983, the base period consists of the 3 immediately preceding taxable years 1980, 1981 and 1982. The amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is \$200x ( $(\$150x + \$200x + \$250x) / 3$ ). The amount determined under paragraph (c)(2) of this section is \$225x (50 percent of the \$450x of qualified research expenses in 1983). Accordingly, the amount of base period research expenses is \$225x. The credit for determination year 1983 is equal to 25 percent of the excess of \$450x (the qualified research expenses incurred during the determination year) over \$225x (the base period research expenses).

*Example 2.* Y, an accrual-basis corporation using the calendar year as its taxable year comes into existence and begins carrying on

a trade or business on July 1, 1983. Y incurs qualified research expenses as follows:

7/1/83—12/31/83 .....	\$80x
1984 .....	200x
1985 .....	200x

(i) *Determination year 1983.* For determination year 1983, the base period consists of the 3 immediately preceding taxable years: 1980, 1981 and 1982. Although Y was not in existence during 1980, 1981 and 1982, Y is treated under paragraph (b) of this section as having been in existence during those years with qualified research expenses of zero. Thus, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is \$0x ( $(\$0x + \$0x + \$0x) / 3$ ). The amount determined under paragraph (c)(2) of this section is \$40x (50 percent of \$80x). Accordingly, the amount of base period research expenses is \$40x. The credit for determination year 1983 is equal to 25 percent of the excess of \$80x (the qualified research expenses incurred during the determination year) over \$40x (the base period research expenses).

(ii) *Determination year 1984.* For determination year 1984, the base period consists of the 3 immediately preceding taxable years: 1981, 1982, and 1983. Under paragraph (b) of this section, Y is treated as having been in existence during years 1981 and 1982 with qualified research expenses of zero. Because July 1 through December 31, 1983 is a short taxable year, paragraph (d)(2) of this section requires that the qualified research expenses for that year be adjusted to \$160x for purposes of determining the average qualified research expenses during the base period. The \$160x results from the actual qualified research expenses for that year (\$80x) multiplied by 12 and divided by 6 (the number of months in the short taxable year). Accordingly, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is  $\$53\frac{1}{3}x$  ( $(\$0x + \$0x + \$160x) / 3$ ). The amount determined under paragraph (c)(2) of this section is \$100x (50 percent of \$200x). The amount of base period research expenses is \$100x. The credit for determination year 1984 is equal to 25 percent of the excess of \$200x (the qualified research expenses incurred during the determination year) over \$100x (the base period research expenses).

(iii) *Determination year 1985.* For determination year 1985, the base period consists of the 3 immediately preceding taxable years: 1982, 1983, and 1984. Pursuant to paragraph (b) of this section, Y is treated as having been in existence during 1982 with qualified research expenses of zero. Because July 1 through December 31, 1982, is a short taxable year, paragraph (d)(2) of this section requires that the qualified research expense for that year be adjusted to \$160x for purposes of determining the average qualified research expenses for

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taxable years during the base period. This \$160x is the actual qualified research expense for that year (\$80x) multiplied by 12 and divided by 6 (the number of months in the short taxable year). Accordingly, the amount determined under paragraph (c)(1) of this section (the average qualified research expenses for taxable years during the base period) is  $\$120x \left( (\$0x + \$160x + \$200x) / 3 \right)$ . The amount determined under paragraph (c)(2) of this section is  $\$100x$  (50 percent of  $\$200x$ ). The amount of base period research expenses is  $\$120x$ . The credit for determination year 1985 is equal to 25 percent of the excess of  $\$200x$  (the qualified research expenses incurred during the determination year) over  $\$120x$  (the base period research expenses).

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