

Accordingly, these new proposed regulations allocate the group credit among the members of the controlled group by first computing each individual member's stand-alone entity credit and then multiplying the group credit by the ratio that the member's stand-alone entity credit bears to the sum of the stand-alone entity credits of all the members of the controlled group. This new allocation method ensures that the amount of group credit allocated to each individual member will be proportionate to the amount of research credit that the individual member would have been entitled to claim had it not been part of a controlled group. This new allocation method therefore addresses the concerns expressed by the commentators that the allocation method contained in the 2000 proposed regulations could result in individual members receiving little or no research credit—or, conversely, a disproportionately greater amount of research credit—compared to what they would have been entitled to on a stand-alone basis, solely as a result of being part of a controlled group.

Special Allocation Rule for Consolidated Groups

In the preamble to the 2000 proposed regulations, Treasury and the IRS requested comments with respect to a special rule that would treat all members of a consolidated group within a controlled group as a single member for purposes of allocating the group credit among the members of a controlled group. After considering the comments received, Treasury and the IRS have decided not to propose a special allocation rule for consolidated groups.

Effective Date

The 2000 proposed regulations provided that they would be effective, when finalized, for taxable years ending on or after the date the proposed regulations were filed with the **Federal Register** (i.e., December 29, 1999). The 2000 proposed regulations, however, were proposed to be retroactive in certain instances 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.

The two commentators disagreed as to the appropriateness of this proposed effective date. In particular, the second commentator stated that it would be “unconscionable” for final regulations containing the allocation method set out in the 2000 proposed regulations to be applied retroactively. The second commentator therefore proposed that final regulations be applied prospectively and that for prior years, taxpayers be permitted to rely on final regulations or any other method that is reasonable, including a gross QREs method. Finally, the second commentator disputed “that there is a potential for abuse if members of a controlled group take inconsistent methods of allocation for past years. The fact that members of the same controlled group may, in the aggregate, claim more than 100% of the group's Research Credit should not make any difference.”

The group credit rules in section 41(f) provide for a total group credit. There is nothing in the statute or the legislative history that suggests that it then should be permissible for the members of the controlled group to claim, in the aggregate, an amount of research credit exceeding the group credit. Treasury and the IRS continue to believe that the purpose of the section 41(f) group credit rules would be undermined if the members of a controlled group applied different allocation methods to claim more than 100 percent of the group credit. The preamble to the 2000 proposed regulations and those proposed regulations themselves eliminated any ambiguity that may have existed with respect to the Treasury and IRS position on this point.

Accordingly, Treasury and the IRS propose that final regulations be effective for taxable years beginning on or after the date that these regulations are published in the **Federal Register** as final regulations. Treasury and the IRS further propose that the final regulations be retroactive in limited circumstances to prevent abuse. Generally, a taxpayer may use any reasonable method of computing and allocating the credit for taxable years beginning before the date these regulations are published in the **Federal Register** as final regulations. However, paragraph (b) relating to the computation of the group credit and paragraph (c), relating to the allocation of the group credit, will apply to taxable years ending on or after December 29, 1999, if the members of a controlled group, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b). In the

case of a controlled group whose members have different taxable years and whose members use inconsistent methods of allocation, the members of the controlled group shall be deemed to have, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b).

Special Analyses

It has been determined that these proposed regulations do not constitute 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these proposed regulations. Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Withdrawal of Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG-105606-99) published in the **Federal Register** on January 4, 2000, (65 FR 258) is withdrawn.

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 as follows:

1. The entry for § 1.41-6(a)(4) is revised.
2. The entries for § 1.41-6(b) through (e) are revised.
3. New entries are added for § 1.41-6(f) through (i).

The revisions and additions read as follows:

§ 1.41-0 Table of contents.

* * * * *

§ 1.41-6 Aggregation of expenditures.

- (a) * * *
- (4) Definition of group credit.
- (b) Computation of the group credit.