



# Amended Returns/Refund Claims Containing Invalid IRC 280C(c)(3) Elections

August 26, 2005

**MEMORANDUM FOR INDUSTRY DIRECTORS  
DIRECTORS, FIELD OPERATIONS  
DIRECTOR, FIELD SPECIALISTS  
DIRECTOR, PRE-FILING AND TECHNICAL GUIDANCE**

**FROM:** Paul D. DeNard /s/ Paul D. DeNard  
Industry Director  
Financial Services

**SUBJECT:** LMSB Directive on Amended Returns/Refund Claims Containing Invalid I.R.C. § 280C(c)(3) Elections

## **Introduction**

The purpose of this memorandum is to reissue guidelines to LMSB examiners when a taxpayer computes the I.R.C. § 41 credit for increasing research activities ("research credit") as set forth in I.R.C. § 280C(c)(3) in an amended return/claim for refund, without having previously made a valid I.R.C. § 280C(c)(3) election on a timely filed original income tax return (including extensions) for the taxable year. This LMSB Directive is not an official pronouncement of the law and cannot be used, cited, or relied upon as such.

## **Applicable Law**

I.R.C. § 41 provides for a research credit. Unused research credit can currently be carried back one year and forward 20 years. I.R.C. § 39. The research credit for any taxable year cannot exceed the excess of the taxpayer's net income tax over the greater of (A) the tentative minimum tax for the taxable year, or (B) 25 percent of so much of the taxpayer's net regular tax liability as exceeds \$25,000. I.R.C. § 38(c)(1). I.R.C. § 280C(c) applies to tax years beginning after December 31, 1988. I.R.C. § 280C(c)(1) provides that, in general, no deduction is allowed for that portion of the qualified research expenses (as defined in I.R.C. § 41(b)) or basic research expenses (as defined in I.R.C. § 41(e)(2)) otherwise allowable as a deduction for the taxable year that is equal to the amount of the credit determined for such taxable year under I.R.C. § 41(a). Under paragraph (2), the same rule applies to capitalized expenses.

I.R.C. § 280C(c)(3)(A) provides for an annual election for a reduced research credit. I.R.C. § 280C(c)(3)(C) provides that an election under this paragraph shall not be made any later than the time for filing the return for tax for the year the credit is claimed, including extensions. Treas. Reg. § 1.280C-4(a) provides that the election shall be made on an original return, and "shall be made by claiming the reduced credit . . . on an original return for the taxable year, filed at any time on or before the due date (including extensions) for filing the income tax return for such year." I.R.C. § 280C(c)(3)(C) further provides that such an election, once made is irrevocable. See Treas. Reg. § 1.280C-4(a).

## **Treatment of Amended Returns/Refund Claims Containing Invalid I.R.C. § 280C(c)(3) Elections**

A taxpayer who failed to make a timely election for the reduced research credit under I.R.C. § 280C(c)(3)(A), avoiding the correlative reduction in otherwise deductible expenses under I.R.C. § 280C(c)(1) and (c)(2), is precluded from making such an election on an amended return/claim for refund. The Code and the Treasury Regulations are clear; such an election may only be made on a timely-filed original return (with extensions). I.R.C. § 280C(c)(3)(C); Treas. Reg. § 1.280C-4(a).

Where such an invalid election is identified, the examiner shall bring this issue to the taxpayer's attention and afford it the opportunity, if available, to further amend its amended return/claim for refund by properly recomputing its research credit under I.R.C. § 280C(c)(1) and (c)(2). Such an amendment must comply with the specific requirements for such claims. See [Notice 2002-44](#), 2002-2 C.B. 39; [Section 41 Credit for Increasing Research Activities \("Research Credit"\): Current Audit Inventory Guidelines and Claim Processing](#) (July 24, 2002). Regardless of whether the amendment is a claim for refund or the reporting of research credit to be carried under I.R.C. § 39, the Team Manager shall direct the taxpayer to file an amended return with the Ogden Service Center, at the address set forth in Notice 2002-44, with a copy to the Team Manager to expedite any examination of the amendment. **Please note that Team Managers shall no longer have the discretion to directly receive a claim for refund that corrects a prior invalid I.R.C. § 280C(c)(3) election.**

If a Taxpayer fails to properly amend a claim for refund to comport with the requirements of I.R.C. § 280C(c), the claim shall be disallowed.

### **I.R.C. § 280C - Penalty Issues**

LMSB has become aware of numerous tax returns and studies, prepared by practitioners, that contain invalid I.R.C. § 280C(c)(3) elections. Depending upon the facts of a particular case, penalties for such conduct may be applicable. See, e.g., I.R.C. §§ 6694 and 6701. Questions concerning the applicability of such penalties, as well as procedures to be followed in such cases, should be referred to Research Credit Technical Advisor A. Lee Keenan at (781) 835-4309.

### **I.R.C. § 280C - Practice Issues**

Practitioners who make invalid I.R.C. § 280C(c)(3) elections on amended returns/claims for refunds, and/or who advise taxpayers to do so, are taking positions that are directly contrary to both the Code and longstanding Treasury Regulations. Accordingly, referral of such conduct to the Service's Office of Professional Responsibility ("OPR") is warranted.

If you have any questions concerning this LMSB Directive, please contact Mary Grady, Staff Assistant, DFO (Manhattan), Financial Services, at (212) 298-2105.

### **Links:**

- [Notice 2002-44](#)
- [LMSB Commissioner Memo. 07-24-2002](#)
- [Form 8484. Report of Suspected Practitioner Misconduct](#)

**1** Although the effect of a valid I.R.C. § 280C(c)(3) election on Federal tax liability varies based upon the facts of a given case, the effect at the state level is much more predictable. Most states adopt Federal taxable income as the starting point for computing state taxable income. From a state tax perspective, the increase in Federal taxable income resulting from deductible expenses disallowed under I.R.C. § 280C(c), unless there is an applicable subtraction modification under state law, will result in an increase to a taxpayer's state tax liability. Most states, however, have no such subtraction modification. In sum, an invalid I.R.C. § 280C(c)(3) election, if not detected and disallowed by the Service, may facilitate the improper avoidance of a taxpayer's state tax liability in the majority of states.

cc: Commissioner and Deputy Commissioner (LMSB)  
Director, Quality Assurance and Performance Management (LMSB)

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Director, Office of Professional Responsibility (SE:OPR)  
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