

# LEGAL UPDATE

May 2010      *By: Michael P. Dunworth and Martin J. Jones*

## IRS GUIDANCE REGARDING QUALIFYING THERAPEUTIC DISCOVERY PROJECT CREDIT

On May 21, 2010, the Internal Revenue Service (“IRS”) released Notice 2010-45,<sup>1</sup> which provides anticipated guidance regarding the filing of claims for a qualifying therapeutic discovery project (“QTDP”) credit. The QTDP credit is a refundable tax credit established by the recently passed Patient Protection and Affordable Care Act, and is directed at companies with not more than 250 employees that have expended money on certain biotechnology research projects described below. The following is a brief summary of the highlights of Notice 2010-45.

### BACKGROUND

The IRS, in consultation with the Secretary of Health and Human Services (“HHS”), has established a program to consider and award certification for qualified investments eligible for the QTDP credit. Applicants may seek credits or grants for up to 50% of qualified expenses incurred in 2009 or 2010. The total amount that will be awarded by the IRS pursuant to this program will not exceed \$1 billion.

In order to be eligible for the program, each project must meet the following three requirements:

1. HHS must determine that the project is designed to:
  - (i) treat or prevent diseases or conditions by conducting pre-clinical activities, clinical trials, and clinical studies, or carrying out research protocols, for the purpose of securing approval of a product under certain enumerated sections of the Federal Food, Drug, and Cosmetic Act or the Public Health Service Act;
  - (ii) diagnose diseases or conditions or to determine molecular factors related to diseases or conditions by developing

molecular diagnostics to guide therapeutic decisions; or

- (iii) develop a product, process or technology to further the delivery or administration of therapeutics.
2. HHS must determine that the project shows reasonable potential to:
    - (i) result in new therapies to treat areas of unmet medical need or to prevent, detect or treat chronic or acute diseases or conditions;
    - (ii) reduce long-term health-care costs in the United States; or
    - (iii) advance significantly the goal of curing cancer within 30 years.
  3. The IRS must determine that the project is among those projects that have the greatest potential to:
    - (i) create and sustain high quality, high-paying jobs in the United States; and
    - (ii) advance United States competitiveness in the fields of life, biological and medical sciences.

### NOTICE 2010-45

Each applicant must file a separate application for each research project. No taxpayer will be entitled to receive more than \$5 million from the program, regardless of the number of qualifying projects conducted by the taxpayer or the amounts expended on such projects. Each application must contain (i) a completed Project Information Memorandum, and (ii) a completed IRS Form 8942 (Application for Certification of Qualified Investments Eligible for Credits and Grants Under the Qualifying Therapeutic Discovery Project Program). The Project Information Memorandum is described in Appendix A to Notice 2010-45. IRS Form 8942 will be made available on the

<sup>1</sup> A copy of Notice 2010-45 is available at <http://www.irs.gov/pub/irs-drop/n-10-45.pdf>.

IRS website no later than June 21, 2010, and no application can be made until such form is made available by the IRS.

The deadline for filing applications under the preliminary certification round is July 21, 2010. There is no benefit in applying before July 21, 2010; however, any application filed after that date will only be considered if the IRS does not award the entire \$1 billion to timely filed applications.

The aggregate amount of the \$1 billion that is available under the program will be awarded pro rata based on the number of successful applicants. For example, after the applications are screened for eligibility, if there are 1,000 eligible applicants, each applicant will be allocated \$1 million of tax credits (one one-thousandth of \$1 billion). The IRS has estimated that there will be approximately 1,200 applicants.

Although the statute requires the IRS to take action on each application within 30 days of submission, Notice 2010-45 states that the IRS will first conduct a preliminary review of each application, pursuant to which the IRS will check the completeness of applications. The IRS will complete its preliminary review of applications by September 30, 2010. Each application will then be deemed to have been submitted on October 1, 2010, and the IRS will make a final determination with respect to each application by October 29, 2010. Applicants will have no rights to a conference with the IRS, and will have no rights to appeal the determination of the IRS.

The Project Information Memorandum described in Appendix A to Notice 2010-45 requires the applicant to specifically describe its qualifying project. It includes 11 questions that are designed to determine the reasons why the project qualifies under the program, and strict limits are given regarding the number of words permitted for each answer. For example, the applicant is given a maximum of 250 words to provide an overview of the project, and is given a maximum of 50 words to answer more specific questions regarding why the project qualifies under the program. As stated above, IRS Form 8942 will be issued by the IRS no later than June 21, 2010. Appendix A to Notice 2010-45 states that IRS Form 8942 will require the applicant to provide details regarding the amounts expended for the project and the number of employees of the applicant.

Applicants have the option of electing to receive grants in lieu of credits pursuant to the application procedure described above. The awarding of grants will be made based on the same criteria as the awarding of tax credits. Each applicant for a grant must register with the Central Contractor Registration, and each application for a grant must include the applicant's Data Universal Numbering System number from Dun & Bradstreet. Grants with respect to expenses incurred in an applicant's 2009 tax year will be awarded by October 29, 2010, and grants with respect to expenses incurred in an applicant's 2010 tax year will be awarded within 30 days after the end of the applicant's 2010 tax year.

Upon the awarding of any tax credit or grant pursuant to this program, the IRS will publicly disclose the identity of the applicant and the amount of the credit or grant.

**Important Notice: To ensure compliance with U.S. Treasury Department regulations, we advise that any discussion of Federal tax issues in this communication was not intended or written to be used, and cannot be used (i) to avoid any penalties imposed under the Internal Revenue Code or applicable provisions of state or local tax law or (ii) to promote, market or recommend to another party any transaction or matter addressed herein.**

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*The foregoing is intended to summarize the IRS Guidance Regarding Qualifying Therapeutic Discovery Project Credit, and does not constitute legal advice. Please contact the Pryor Cashman attorney with whom you work with any questions you may have.*

*If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Michael P. Dunworth at (212-326-0833), Stephen M. Goodman at (212-326-0146), Jeffrey C. Johnson at (212-326-0118) or Martin J. Jones at (212-326-0145)*

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## ABOUT THE AUTHORS



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Michael Dunworth is a partner in Pryor Cashman's Tax Group with a broad-based transactional practice. Mr. Dunworth advises on federal income tax issues involved in international and domestic project financing, infrastructure investments, mergers and acquisitions, equipment and facility leasing, real estate and partnership transactions, and related tax controversy work. He has represented investors in and sponsors of investment funds, lessors, lenders and lessees in leasing transactions, and investors in real estate, affordable housing, historic rehabilitation, alternative energy and infrastructure transactions.

Mr. Dunworth's recent experience includes representing:

- An Australian investment fund in the acquisition of a \$1.6 billion of electric generating stations
- The fund sponsor on the restructuring of a \$60 million international real estate fund
- A real estate developer in obtaining a private ruling from the IRS on the treatment of payments in lieu of taxes (PILOT)
- A Singapore investment fund on structuring the acquisition of a partnership interest in a \$350 million electric transmission line project
- The fund sponsor in the formation of a \$150 million real estate fund
- Investment banks in developing partnership structures for infrastructure investments
- A foreign real estate fund in the acquisition of a \$56 million multifamily housing development
- The subsidiary of a Japanese bank in connection with the audit of its leasing portfolio
- Parties to like-kind exchange transactions involving commercial real estate
- The Creditors' Committee in the Mirant Corporation bankruptcy
- Lessors and lessees in restructuring their lease obligations
- Equity investors, lenders and lessees in true lease financings of aircraft, rolling stock, equipment and facilities located in Austria, Belgium, Canada, France, Germany, Ireland, Korea, New Zealand, The Netherlands, Singapore and the United States
- Sellers and purchasers of leveraged lease portfolios
- The lenders in a series of structured financings for California power companies
- Investors in U.S. wind energy projects
- Investors and developers in historic rehabilitation projects
- Investors in affordable housing projects

Mr. Dunworth, who served in the United States Marine Corps Reserves, practiced as a certified public accountant during the early 1980's.

He received his LL.M in Taxation from New York University School of Law, his J.D. from Pace University (*cum laude*) and a B.S. in Accounting from Manhattan College.



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Martin Jones is Of Counsel in Pryor Cashman's Tax Group. His experience includes structuring corporate and partnership transactions, and researching the tax consequences thereof, including mergers, acquisitions, liquidations, limited liability company formations, bankruptcy restructurings. Martin's representative transactions include:

- Acquisition of all outstanding stock in several coal mining companies
- Acquisition of New York City development site for the construction of a condominium building
- Bankruptcy reorganization of company and creation of trusts to discharge asbestos-related liabilities
- Cross-border financing of production costs for a motion picture filmed outside the United States
- Formation of venture capital fund specializing in the healthcare industry
- Joint venture for the development of a resort in the Caribbean
- Managed residency audit of New York State personal income taxpayer
- Obtained a settlement of a New York State sales tax case for approximately 20 percent of the original assessment
- Operating agreement for company formed to operate furniture stores
- Structuring tenant in common (TIC) arrangements to facilitate deferred like-kind exchanges of real estate