Client Alert.

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THERAPEUTIC TAX CREDIT ROLLOUT ANTICIPATED FOR MAY 22, 2010

By Stephen B. Thau and Andrew T. Hall

On or before May 22, 2010, the Treasury Department is expected to announce regulations implementing the Qualified Therapeutic Discovery Project Credit. The announcement will put in motion the process by which the Treasury Department, in consultation with the Department of Health and Human Services, will allocate $1 billion among small businesses that have made or will make qualified investments in certain therapeutic discovery projects in 2009 or 2010. What makes this tax credit especially attractive is that businesses can elect to receive a grant in lieu of the nonrefundable tax credit; such a grant is not includible in gross income, although it is subject to recapture if an investment ceases to be a qualified investment. With approximately one month remaining before the announcement, eligible businesses should become familiar with the tax credit, so that they are well positioned to take advantage of the program once the application process is announced.

BACKGROUND:

On March 23, 2010, President Obama signed the $1 billion Qualified Therapeutic Discovery Project Credit into law as part of the Patient Protection and Affordable Care Act. The credit provides businesses whose applications are approved and certified by the Treasury Department with a tax credit or grant equal to 50 percent of the amount of its qualified investment. Both ongoing projects and projects completed in 2009 are eligible under the program.

ELIGIBILITY:

Which businesses can participate?

Only businesses with 250 or fewer employees will qualify for the tax credit. Control group rules apply in determining the number of employees. Applicants may elect to receive a grant in lieu of a tax credit, such that businesses with little or no tax liability in 2009 and 2010 can also benefit from the program.

Which projects qualify?

A qualifying therapeutic discovery project is a project designed to develop a product, process, or therapy to diagnose, treat, or prevent diseases and afflictions by (a) conducting pre-clinical activities, clinical trials, clinical studies, and research protocols or (b) developing technology or products designed to diagnose diseases and conditions, including molecular and companion drugs and diagnostics, or to further the delivery or administration of therapeutics.

Which expenses count toward the credit?

Expenses that are necessary for and directly related to the conduct of a given qualified therapeutic discovery project, in the aggregate, constitute the qualified investment for such project. Businesses can elect to include expenditures related to depreciable property in the qualified investment, but, if doing so, must reduce the tax basis for the property by the amount of the credit. The qualified investment does not include:

- Compensation paid to the chief executive officer and the four highest-paid employees other than the chief executive officer;
- Interest expense;
- Facility maintenance expense;
- Service costs, including indirect costs that can be identified with a service department or function (e.g. personnel, accounting, data processing, legal or similar departments) or that directly benefit or are incurred by reason of a service department or function; or
- Any other expense as determined by the Treasury Secretary.

To qualify, amounts must be paid or incurred after December 31, 2008.

APPLICATION PROCESS:

The Act charges the Treasury Secretary with adopting and announcing, by May 22, 2010, the application process to administer distribution of the $1 billion in tax credits. The Act requires the Treasury Secretary to take action to approve or deny any application within 30 days of the submission of such application.

SELECTION CRITERIA:

The Treasury Secretary and Secretary of Health and Human Services will select projects for certification based on the eligibility requirements described above, as well as the project's reasonable potential to:

- result in new therapies to treat areas of unmet medical need or to prevent, detect, or treat chronic or acute disease conditions;
- reduce long-term healthcare costs in the United States; or
- significantly advance the goal of curing cancer within a 30-year period.

Additionally, preference will be given to projects with the greatest likelihood of:

- creating and sustaining (directly or indirectly) high-quality, high-paying jobs in the United States; and
- advancing the United States' competitiveness in the fields of life, biological, and medical sciences.

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