

Taking Advantage of the Life Science R&D Tax Credit/Grant Program

Contained within the recent health care reform law is a significant program benefiting life science companies called the “Qualifying Therapeutic Discovery Project Credit.” This program establishes a tax credit of 50% on “qualified investments” in a “qualified therapeutic discovery project.” Importantly, companies receiving a credit under the program can choose to receive a cash grant in the amount of the credit. Thus, companies do not need to be revenue-generating. One billion dollars has been set aside for the program which applies to investments made in tax years 2009 and 2010.

What is a “Qualifying Therapeutic Discovery Project”?

A Qualifying Therapeutic Discovery Project is a project designed to do one of the following:

1. 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 federal approval of a product by the FDA;
2. Diagnose diseases or conditions or determine molecular factors related to diseases or conditions by developing molecular diagnostics to guide therapeutic decisions; or
3. Develop a product, process or technology to further the delivery or administration of therapeutics.

What Investments Qualify for the Credit/Grant?

The program provides credits/grants for “qualified investments,” which are expenses paid or incurred in 2009 or 2010 necessary for and directly related to the conduct of a Qualifying Therapeutic Discovery Project. Certain expenses **do not** count as qualified investments, including:

1. Payments to employees described in Section 162(m)(3) of the tax code (the CEO and up to 4 highly compensated officers);
2. Interest expenses;
3. Facility maintenance expenses (i.e., mortgage/rent, insurance, utility and maintenance costs, and employment costs of maintenance personnel); and
4. Service cost under Treasury Regulation 1.263A-1(e)(4) (G&A-type expenses).

What Companies are Eligible for the Program?

An entity with no more than 250 employees in all of its businesses at the time of application is eligible.

What are the Application Criteria?

The Treasury Department in consultation with the Department of Health and Human Services will be reviewing applications based on the following criteria:

Projects that show reasonable potential to:

1. Result in new therapies to treat areas of unmet medical need; or
2. Result in new therapies to prevent, detect or treat chronic or acute diseases; or
3. Reduce long-term health care costs in the U.S.; or
4. Significantly advance the goal of curing cancer within 30 years.

And

Projects that have the greatest potential to:

- A. Create and sustain high quality, high paying U.S. jobs; and
- B. Advance U.S. competitiveness in the fields of life, biological, and medical sciences.

Thus, each project will need to address at least one of criteria 1-4 and both of criteria A and B.

What are Important Timelines for this Program?

It is expected that the Treasury Department will issue guidance on or about May 21, 2010 detailing the application procedure and clarifying requirements for expense eligibility, selection criteria, etc. Given that the Qualifying Therapeutic Discovery Project Credit is modeled after an energy tax credit, it is expected there will be a short time between the issuance of the guidance and the due date for the preliminary application (there was a 30-day period with the energy credit).

What is the Application Process?

Although more details regarding the application process will be set forth in the Treasury guidance, there are certain aspects the application should have in common with other R&D tax credit programs. The program credits/grants will almost certainly be reviewed and issued on a project-by-project basis. The Treasury will accept or deny the credit within 30 days of submission and will have 30 days from the later of (i) grant application or (ii) the date the actual investment for the subject of the credit is made to pay a grant. Companies can apply for more than one project. Companies can apply for 2009 and 2010 investments, even for investments that have not yet been made. If the application for 2010 investments is accepted, the company can either take the credit on its 2010 tax filing or file an application for a grant on those 2010 investments once they have been made (but prior to the due date for its 2010 tax return). There will be a recapture method on 2010 grants if it is subsequently determined a grant was greater than the allowable amount.

Helpful Tips

- Start the process now, the application period will be short – begin identifying projects with qualified investments
- The program will be oversubscribed so prioritize projects and devote more time to those more likely to be accepted. Projects that address multiple criteria goals will likely score higher than projects that merely qualify by satisfying one goal.
- Your application will likely be subject to Freedom of Information Act requests so consider what information is disclosed. If confidential information may make the application stronger, discuss with counsel the instructions for protecting confidential or sensitive business information.
- Consider whether any confidential information of third parties is being disclosed in an application. Discuss with counsel whether it may be protected and consider the effects it may have on the relationship with the third party.

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- Expenditures accepted as qualified investments will not qualify for research and development credits, orphan drug credits or bonus depreciation. Expenditures accepted as qualified investments related to property subject to depreciation will result in the basis of the property being reduced by the amount of the credit.

Together with your accounting/tax team and auditors, Fabbri Law is available to assist you with the application process.

William Fabbri
617-875-7190
wfabbri@comcast.net

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