KBKG Tax Insight Update – The Effects of Tax Reform on R&D and Orphan Drug Tax Credits

The Senate on December 2, 2017, passed its version of the Tax Cuts and Jobs Act (TCJA) by a vote of 51-49. This is another key step toward passage of this comprehensive tax legislation by year end. However, the final Senate bill continues to differ from the tax bill passed by the House in mid-November.

Although both plans continue to keep the research and development tax credit in place, changes in the tax code will require some additional planning for taxpayers currently claiming or those planning on claiming the R&D tax credit and the Orphan Drug Tax Credit.

Orphan Drug Tax Credit
As it currently stands, the House proposes to repeal the Orphan Drug tax credit in its entirety whereas the Senate proposes to reduce the credit from 50 percent to 27.5 percent of the qualified clinical testing expenditures for the taxable year.

The Senate version would also allow taxpayers to elect a reduced credit in lieu of reducing otherwise allowable deductions in a manner similar to the R&D tax credit under section 280C.

Under either proposal, orphan drug developers stand to lose all or a portion of a significant tax incentive that helps lower the cost of their development programs.

Alternative Minimum Tax
Prior to the final approved Senate version, both the House and the Senate Finance Committee proposed to repeal the corporate AMT. However, the bill ultimately passed by the Senate leaves the AMT in place.

Presently, the R&D tax credit cannot be used to offset a company's AMT liability (except in the case of an eligible small business). If repealed, the AMT would no longer serve as a barrier for companies to realize the R&D tax credit benefit.

However, if it is not repealed, the barrier will stand and it would essentially nullify the R&D tax credit for many other companies since the proposed corporate rate of 20 percent could drive many companies into an AMT position.

What's Next?
Once appointed, the Joint Conference Committee is responsible for negotiating a final tax bill. The final version must be approved by both the House and Senate before it can be sent to the President for review.

Although the Senate bill would retain the AMT, there is support by senior members of both parties to repeal it in the final approved legislation. It is expected to be a top priority in the conference. The Committee is expected to meet this week.

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