



TaxNewsFlash

United States



No. 2023-173
May 17, 2023

U.S. Tax Court: Expenses under orphan drug credit under section 45C must also be taken in account in determining research credit under section 41

The U.S. Tax Court today held that expenses used to determine the orphan drug credit under section 45C must also be taken into account in determining certain elements of the research credit under section 41, with the result that a taxpayer claiming both credits receives a reduced research credit.

The case is: *United Therapeutics Corporation v. Commissioner*, 160 T.C. No. 12 (May 17, 2023). Read the Tax Court's [opinion](#) [PDF 408 KB] (36 pages)

Summary

The taxpayer was a biotechnology company that claimed both the research credit under section 41 and the orphan drug credit under section 45C for each of the tax years 2011 through 2014. Some of the taxpayer's expenses during those years qualified as both qualified clinical testing expenses under section 45C and qualified research expenses under section 41. For those expenses, the taxpayer elected to claim the orphan drug credit under section 45C.

In determining the research credit for 2014, the taxpayer elected to use the alternative simplified credit calculation under section 41(c)(5) and the reduced credit under section 280C(c)(3). When calculating the credit under section 41(c)(5), the taxpayer excluded qualified clinical testing expenses from both its 2014 qualified research expenses and its average qualified research expenses for the three preceding tax years (2011 through 2013).

The IRS determined that the taxpayer overstated its research credit for 2014 by improperly excluding from its computations the expenses the taxpayer treated as qualified clinical testing expenses for 2011 through 2013. The IRS argued that qualified clinical testing expenses must be included in calculating

qualified research expenses for the three preceding years under section 45C(c)(2). This is similar to the analysis that the IRS applied in TAM 201740018.

The taxpayer petitioned the Tax Court for redetermination, contending that because of changes in section 41 since its original enactment, section 45C(c)(2) is a dead letter.

The Tax Court held that the text and structure of sections 41 and 45C(c)(2) as they existed for 2014 supported the IRS position. The court determined that the ordinary meaning of section 45C(c)(2) must be given effect and that there was no basis for ignoring the provision altogether as a no-longer-effective rule that Congress neglected multiple times to remove from the Code. The court stated that “[i]n interpreting clear statutory text, we normally do not assume that Congress made a mistake in drafting, and we certainly do not assume that it made the same mistake repeatedly. We see no reason to depart from that practice here.”

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