



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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CC:DOM:P&SI:5
SPR-113277-98
April 21, 1999

MEMORANDUM FOR

FROM:

CC:DOM:P&SI:5

SUBJECT: Section 38(c)(2) Limitation
SPR-113277-98

This memo is in response to your request dated _____ for assistance regarding an interpretation problem with § 38(c)(2) of the Internal Revenue Code (as amended by the Technical Corrections Act of 1988 and before the repeal by the Revenue Reconciliation Act of 1990).

The above matter concerns two conflicting interpretations of § 38(c)(2) and the interpretations taken in the _____. The first interpretation holds that only the regular investment tax credit (ITC) component of the general business credit (GBC) may be claimed as a result of the increased limitation under § 38(c)(2). You represent that this interpretation is used in _____. However, in the _____ memo from _____ (a copy of which you have), _____ concluded that after comparing both programs, _____ subscribes to the second interpretation of § 38(c)(2).

The second interpretation, which is followed in _____, holds that, in addition to regular ITC, other components of the GBC may be claimed as a result of the increased limitation.

Although the _____ are not in conflict, the issue remains as to which interpretation of § 38(c)(2) is supported by the statute.

LAW and ANALYSIS

Section 38(a) provides that there shall be allowed as a credit against tax imposed for the taxable year an amount equal to the sum of the business credit carryforwards carried to such taxable year, the amount of the current year business

credit, plus the business credit carrybacks carried to such taxable year. The amount of the current year business credit, pursuant to § 38(b) is the sum of the investment credit, the targeted jobs credit, the alcohol fuels credit, the research credit, and the low-income housing credit.

Section 38(c) imposes a limitation on the amount of credits allowed under § 38(a) for any taxable year. Section 38(c)(1)(A) limits the GBC to the excess of the taxpayer's net income tax over the TMT for the taxable year. Section 38(c)(2), which applies only to C corporations, modifies the limitation by reducing the amount determined under § 38(c)(1)(A) by the portion of regular ITC not used against the § 38(c)(1) limitation, up to 25 percent of TMT. The effect of this modification is to increase the amount of the GBC allowable, provided the requirements are met. However, a question has arisen as to which components of the GBC may be claimed as a result of the increased limitation.

The heading of § 38(c)(2) implies that only the remaining regular ITC available after the application of the § 38(c)(1) limitation may be claimed. If § 38(c)(2) is interpreted as suggested in the heading, § 38(c)(2) would change the usual ordering rules of § 38.

Section 38(a) provides that the GBC operates on a first-in first-out basis. Section 38(d) provides that, in general, the order in which the components of the GBC are used shall be determined on the basis of the order in which they are listed in subsection (b) as of the close of the taxable year in which the credit is used.

We believe that, notwithstanding the heading of § 38(c)(2), Congress did not intend for this subsection to alter the usual ordering rules of § 38. Section 38(c)(2)(A) only modifies the amount described in § 38(c)(1)(A). The text of § 38(c)(2)(A) does not address which of the individual components of the GBC are to be claimed as a result of the increased limitation. Absent a special rule in the statute, the usual rules applicable for determining which credits are used in a taxable year apply. This view is supported by a statement in the Senate Finance Committee Report on the Technical Corrections Act of 1988 which states that § 38(c)(2) affects only the determination of the amount of the GBC allowable in a taxable year and does not change the usual ordering rules of § 38.

Therefore, we conclude that the interpretation of § 38(c)(2) followed in _____ is correct. Section 38(c)(2) modifies § 38(c)(1) by increasing the amount of the GBC allowable without any restriction as to which of the components of the GBC may be claimed.

In a recent meeting with representatives from Forms and Publications, they agreed with the recommended interpretation of § 38(c)(2) and will revise the Form 3800 and its related worksheet accordingly, beginning with the _____ taxable year.

If you have any questions, please contact _____ at _____ .