United Therapeutics Corp. v. Commissioner of Internal Revenue, 160 T. C. No. 12 (2023)

In a landmark decision, the United States Tax Court ruled that expenses used for the orphan drug credit must also be considered when calculating the research credit, impacting how biotech firms like United Therapeutics Corp. can claim tax benefits. The court's interpretation of the Internal Revenue Code clarified that the coordination rule between the two credits remains effective, despite legislative amendments, ensuring that taxpayers account for overlapping expenses in their credit calculations.

Parties

United Therapeutics Corporation, a biotechnology company, was the petitioner in this case. The respondent was the Commissioner of Internal Revenue, representing the Internal Revenue Service (IRS). The case was adjudicated in the United States Tax Court under Docket No. 10210-21.

Facts

United Therapeutics Corporation, a Delaware public benefit corporation, focuses on developing treatments for chronic and life-threatening conditions, including pulmonary arterial hypertension and neuroblastoma. For the tax years 2011 through 2014, the company claimed both the research credit under I. R. C. § 41 and the orphan drug credit under I. R. C. § 45C. Some expenses during these years qualified for both credits. United Therapeutics elected to claim the orphan drug credit for those expenses. In calculating the 2014 research credit, the company used the alternative simplified credit method under I. R. C. § 41(c)(5) and excluded the qualified clinical testing expenses from both the 2014 qualified research expenses and the average qualified research expenses for the preceding three years (2011-2013). The Commissioner audited the return and issued a Notice of Deficiency, asserting that United Therapeutics had overstated its research credit by improperly excluding the qualified clinical testing expenses from its computations.

Procedural History

Following the issuance of the Notice of Deficiency by the Commissioner, United Therapeutics timely petitioned the United States Tax Court for redetermination. The case proceeded under Rule 122 of the Tax Court Rules of Practice and Procedure, and the parties submitted the case fully stipulated. The Tax Court reviewed the statutory interpretation issues de novo.

Issue(s)

Whether the expenses used to determine the orphan drug credit under I. R. C. § 45C must also be taken into account in determining the research credit under I. R. C. § 41, particularly when calculating the alternative simplified credit under I. R. C. §

41(c)(5)?

Rule(s) of Law

The relevant statutory provisions are I. R. C. § 41, governing the research credit, and I. R. C. § 45C, governing the orphan drug credit. I. R. C. § 45C(c) provides the coordination rule between the two credits, stating: “(1) In general. —Except as provided in paragraph (2), any qualified clinical testing expenses for a taxable year to which an election under this section applies shall not be taken into account for purposes of determining the credit allowable under section 41 for such taxable year. (2) Expenses included in determining base period research expenses. —Any qualified clinical testing expenses for any taxable year which are qualified research expenses (within the meaning of section 41(b)) shall be taken into account in determining base period research expenses for purposes of applying section 41 to subsequent taxable years. “

Holding

The Tax Court held that the text and structure of I. R. C. §§ 41 and 45C(c)(2) as they existed for 2014 require that qualified clinical testing expenses used to determine the orphan drug credit must be taken into account in calculating the average qualified research expenses for the three preceding years when determining the research credit under the alternative simplified credit method.

Reasoning

The Tax Court’s reasoning centered on statutory interpretation. It emphasized that the starting point for interpretation is the ordinary meaning and structure of the law itself. The court rejected United Therapeutics’ argument that the phrase “base period research expenses” should be read as a defined term from a predecessor statute, noting that Congress had removed the relevant definition from the Code in 1989. The court interpreted “base period” according to its ordinary meaning as a period used as a standard of comparison. Applying this interpretation to I. R. C. § 45C(c)(2), the court concluded that the provision required the inclusion of qualified clinical testing expenses in the calculation of the average qualified research expenses for the three years preceding the credit year. The court also dismissed United Therapeutics’ reliance on the consistency rule of I. R. C. § 41(c)(6)(A), clarifying that the rule applies only to the definition of qualified research expenses and does not conflict with the coordination rule of I. R. C. § 45C(c)(2). The court emphasized that policy arguments could not override the clear statutory directive and that Congress’s repeated amendments to the relevant provisions without modifying the coordination rule indicated an intent to maintain its effect.

Disposition

The Tax Court entered a decision in favor of the Commissioner, upholding the Notice of Deficiency and requiring United Therapeutics to include its qualified clinical testing expenses in the calculation of its average qualified research expenses for the years 2011 through 2013 when determining its 2014 research credit under the alternative simplified credit method.

Significance/Impact

This decision clarifies the interaction between the research credit and the orphan drug credit, ensuring that taxpayers claiming both credits account for overlapping expenses in their credit calculations. It underscores the importance of statutory text and structure in tax law interpretation and reaffirms the principle that Congress's legislative choices should be respected unless there is clear evidence of legislative intent to change them. The ruling has significant implications for biotechnology companies and other taxpayers claiming multiple tax credits, as it may affect their tax planning and the calculation of their tax liabilities. The decision also highlights the need for careful statutory drafting and the challenges of interpreting tax laws that have been repeatedly amended over time.

