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108TH CONGRESS
1ST SESSION

H. R. 2968

To permit biomedical research corporations to engage in certain equity financings without incurring limitations on net operating loss carryforwards and certain built-in losses, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 25, 2003

Mr. REYNOLDS (for himself, Mr. CANTOR, Mr. MATSUI, Mr. CARDIN, and Mr. HOLT) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To permit biomedical research corporations to engage in certain equity financings without incurring limitations on net operating loss carryforwards and certain built-in losses, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Biotechnology Future Investment Expansion Act of 2003''.

SEC. 2. FINDINGS AND PURPOSE.

(a) FINDINGS.—Congress finds the following:

(1) American bioscience research corporations conduct long-term research and development on breakthrough medical technologies. This commercial bioscience research industry forms an irreplaceable link between pure scientific discovery and the development of powerful biomedical products and technologies. It is critical to the maintenance of American competitiveness internationally that these long-term research and development projects be encouraged.

(2) Such long-term research projects have the greatest potential to revolutionize whole fields of science and industry for the benefit of the standard of living of Americans; and to yield solutions for critical social needs, even though these solutions might not result in large sales and profits (such as ''orphan'' drugs and other treatments alleviating great suffering in their recipients).

(3) Long-term biomedical research companies are among the most research-intensive and capital-intensive companies in the world.

(4) In addition to the scientific and technical risks attending their long-term research programs, many biomedical research companies must subject their technologies to lengthy and expensive regu-

latory reviews before they are permitted access to the marketplace.

(5) Biomedical research companies typically operate in financially challenging circumstances. These companies must engage in intensive research activity for many years in order to develop their products and earn profits. Many are small businesses lacking the internal cash flow, stability and borrowing capacity of large corporations.

(6) The long-term commercial bioscience research industry is heavily dependent on outside sources of equity capital to fund lengthy and intensive research prior to earning any revenues. The industry's long lead times and high levels of scientific and regulatory risk often impede access to capital.

(7) The longstanding national policy of Government support and tax incentives for breakthrough commercial research reflects a recognition that the capital marketplace tends to allocate insufficient resources to sustain the Nation's need for such foundational scientific research and development.

(8) American long-term bioscience research companies constitute one of the core commercial sectors which Congress intended to benefit from existing tax incentives for commercial research.

(9) However, the current Federal income tax incentives are simply not working in the case of many bioscience companies focused on breakthrough medical technologies.

(10) Current Federal income tax incentives do not work as intended for most high technology bioscience companies because they typically incur net operating losses for a decade or more during their lengthy research and development phases and therefore receive no contemporaneous benefit from these tax incentives.

(11) Further, Federal tax rules aimed chiefly at preventing corporate loss trafficking and tax-motivated mergers and acquisitions penalize these companies. The very process of raising successive increments of private capital through routine equity financings triggers these rules and subjects biomedical research companies to severe limitations on net operating loss and tax credit carryforwards. These limitations practically eliminate for the commercial bioscience industry any economic benefit from these tax incentives.

(12) These tax incentives instead tend to favor investment by large, profitable companies, often engaged in secondary or tertiary research activities,

and thus to discriminate against and to cause underinvestment in longer-term breakthrough technologies, a bias which is harmful to American competitiveness.

(13) The inability to benefit from existing Federal income tax incentives for commercial research places long-term bioscience research companies at a substantial disadvantage in the capital marketplace where they must compete with other companies able to use these tax incentives currently.

(14) A tax system that does not discriminate would ensure that existing tax incentives in favor of research and experimentation have the same cost-reducing impact on companies conducting both short-term and long-term research and thus render this tax incentive program neutral with regard to short-term and long-term research objectives, minimizing capital marketplace distortions caused by differences in tax and income status.

(b) PURPOSE.—The purpose of this Act is to provide that long-term biomedical research corporations will not incur limitations on research-related tax incentive carryforwards simply because they engage in the routine equity financings that are the financial lifeblood of the industry.

SEC. 3. RESTORING THE BENEFIT OF TAX INCENTIVES FOR BIOMEDICAL RESEARCH AND CLINICAL TRIALS.

(a) IN GENERAL.—Subsection (l) of section 382 of the Internal Revenue Code of 1986 is amended by adding at the end the following new paragraph:

''(9) CERTAIN FINANCING TRANSACTIONS OF BIOMEDICAL RESEARCH CORPORATIONS.—

''(A) GENERAL RULE.—In the case of a biomedical research corporation, any owner shift involving a 5-percent shareholder which occurs as the result of a qualified investment during the testing period shall be treated for purposes of this section (other than this paragraph) as occurring before the testing period.

''(B) BIOMEDICAL RESEARCH CORPORATION.—For purposes of this paragraph, the term 'biomedical research corporation' means, with respect to any qualified investment, any domestic corporation subject to tax under this subchapter which is not in bankruptcy and which, as of the time of the closing on such investment—

''(i) holds the rights to a drug or biologic for which an investigational new drug application is in effect under section 505

of the Federal Food, Drug, and Cosmetic Act, and

''(ii) certifies that, as of the time of such closing, the drug or biologic is under study in phase II or phase III of a clinical investigation carried out under such section.

''(C) QUALIFIED INVESTMENT.—For purposes of this paragraph, the term 'qualified investment' means any acquisition of stock in a biomedical research corporation if such stock is acquired at its original issue (directly or through an underwriter), solely in exchange for cash, and the closing thereon occurs after the date of the enactment of this paragraph.

''(D) STOCK ISSUED IN EXCHANGE FOR CONVERTIBLE DEBT.—For purposes of this paragraph, stock issued by a biomedical research corporation in exchange for its convertible debt (or stock deemed under this section to be so issued) shall be treated as stock acquired by the debt holder at its original issue and solely in exchange for cash if the debt holder previously acquired the convertible debt at its original issue and solely in exchange for cash.

In the case of an acquisition of stock in exchange for convertible debt, the requirements of this paragraph shall be applied separately as of the time of closing on the investment in convertible debt, and as of the time of actual conversion (or deemed conversion under this section) of the convertible debt for stock, except that the requirements of subparagraph (H) shall be applied only as of the time of closing on the issuance of the convertible debt.

''(E) BIOMEDICAL RESEARCH CORPORATION MUST MEET 5-YEAR EXPENDITURE TEST WITH RESPECT TO ANY QUALIFIED INVESTMENT.—

''(i) IN GENERAL.—This paragraph shall not apply to a qualified investment in a biomedical research corporation unless such corporation meets the expenditure test for each year of the measuring period.

''(ii) MEASURING PERIOD.—For purposes of this subparagraph, the term 'measuring period' means, with respect to any qualified investment, the taxable year of the biomedical research corporation in which the closing on the investment occurs,

the 2 preceding taxable years, and the 2 subsequent taxable years.

''(iii) EXPENDITURE TEST.—A biomedical research corporation meets the expenditure test of this subparagraph for a taxable year if at least 25 percent of its expenditures for the taxable year (including, for purposes of this clause, payments in redemption of its stock) are expenditures described in section 41(b) which are paid or incurred for clinical testing or preclinical biomedical research.

''(iv) CLINICAL TESTING.—For purposes of this subparagraph, the term 'clinical testing' means any human clinical testing which is carried out under any investigational new drug application in effect under section 505 of the Federal Food, Drug, and Cosmetic Act.

''(F) EFFECT OF CORPORATE REDEMPTIONS ON QUALIFIED INVESTMENTS.—Rules similar to the rules of section 1202(c)(3) shall apply to qualified investments under this paragraph except that 'stock acquired in a qualified investment' shall be substituted for 'qualified

small business stock' each place it appears therein.

"(G) EFFECT OF OTHER TRANSACTIONS BETWEEN BIOMEDICAL RESEARCH CORPORATIONS AND INVESTORS MAKING QUALIFIED INVESTMENTS.—

"(i) IN GENERAL.—If, during the 2-year period beginning 1 year before any qualified investment, the biomedical research corporation engages in another transaction with a member of its qualified investment group and such biomedical research corporation receives any consideration other than cash in such transaction, there shall be a presumption that stock received in the otherwise qualified investment transaction was not received solely in exchange for cash.

"(ii) QUALIFIED INVESTMENT GROUP.—For purposes of this subparagraph, the term 'qualified investment group' means, with respect to any qualified investment, one or more persons who receive stock issued in exchange for the qualified investment, and any person re-

lated to such persons within the meaning of section 267(b) or section 707(b).

''(iii) REGULATIONS.—The Secretary shall promulgate regulations exempting from this subparagraph transactions which are customary in the bioscience research industry and are of minor value relative to the amount of the qualified investment.

''(H) PROCEEDS OF QUALIFIED INVESTMENTS SHALL BE DEVOTED TO RESEARCH ON PREEXISTING TECHNOLOGY.—

''(i) IN GENERAL.—This paragraph shall not apply to any qualified investment unless the net proceeds of such qualified investment do not exceed the excess of—

''(I) the sum of the biomedical research corporation's aggregate qualifying clinical expenditures for the 3 years following the qualified investment, over

''(II) three times the corporation's qualifying clinical expenditures for the year preceding the qualified investment, plus the amount of the corporation's cash and cash equiva-

lents immediately before the closing on the qualified investment.

''(ii) QUALIFYING CLINICAL EXPENDITURES.—For purposes of this subparagraph, the term 'qualifying clinical expenditures' means amounts described in section 41(b) which are paid or incurred by a biomedical research corporation for clinical testing in connection with a drug or biologic for which an investigational new drug application is in effect under section 505 of the Federal Food, Drug, and Cosmetic Act and which is (at the time of the closing on the qualified investment) under study in phase II or phase III of a clinical investigation carried out under such section.

''(I) REGULATIONS.—The Secretary may issue such regulations as may be appropriate to achieve the purposes of this paragraph, to prevent abuse, and to provide for treatment of biomedical research corporations under sections 383 and 384 that is consistent with the purposes of this paragraph.''.

(b) PROCEEDS OF EQUITY INVESTMENTS TO BE TREATED AS WORKING CAPITAL.—Subparagraph (C) of section 382(l)(4) of such Code is amended by adding at the end the following: ''Such term shall not include any assets reasonably expected to be used within 3 years to fund qualifying clinical expenditures (as defined in paragraph (9)(H)(ii) without regard to the parenthetical therein).''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

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