H.R. 2297, the PARTNER Act

Partnerships to Advance Revolutionary Technology and Novel Entrepreneurial Research

The vast majority of small, research-intensive companies are not yet profitable. Their long development timelines and high-risk research mean that it could take more than a decade to sell a product or realize a profit. Further, the capital burden necessary to fund years of groundbreaking research is significant. Thus, innovative firms rely heavily on private investment rather than product revenue to fund their promising research. Policies designed to stimulate private investment in cutting-edge R&D will speed the development process and create highquality research jobs.

The PARTNER Act, sponsored by Reps. Meehan, Neal, Kelly, Kind, and Larson recognizes this unique feature of innovative small businesses by including key reforms to Section 469 of the tax code, which governs the treatment of operating losses and tax credits generated by growing innovators. Because many small R&D businesses are pre-revenue, they accumulate both net operating losses from their extended development timeline and tax credits for their research as deferred tax assets. These incentives are designed to be beneficial once a company becomes profitable; however, product revenue remains on a distant horizon for small innovators, and these deferred assets do not encourage much-needed immediate investments in important R&D.

Prior to the 1986 Tax Reform Act, innovative R&D was often conducted through so-called "R&D Limited Partnerships," in which individual investors financed R&D projects through entities that were taxed as pass-throughs. These individual investors were then able to offset other income with the losses and tax credits generated by the R&D project. However, the enactment of the passive activity loss (PAL) rules under Section 469 of the tax code significantly restricted the ability of losses and credits to flow from project to investor.

The PARTNER Act would relax the PAL limitations for R&D-focused pass-through entities. Under the bill, small businesses would be able to enter into a joint venture with an R&D project's investors via R&D Partnership Structures. The losses and credits generated by the research would then flow through to the company and investors, who would be able to use the tax assets to offset other income.

The bill would apply to entities that devote a significant percentage of their expenses to R&D, have fewer than 250 employees, and have less than $150 million in gross assets. These emerging, pre-revenue businesses are vital to growing America's innovation economy.

Relaxing the PAL rules to allow investors to enjoy a more immediate return on their investment, despite the long and risky timeline usually associated with groundbreaking research, would incentivize them to invest at an earlier stage, when the capital is most needed. By making targeted changes for small, R&D-intensive companies, the PARTNER Act would stimulate capital formation for growing innovative businesses and speed the development of groundbreaking technologies