

IRM PROCEDURAL UPDATE

DATE: 04/27/2023

NUMBER: wi-21-0423-0556

SUBJECT: Revised Form 8974 Processing Guidance

AFFECTED IRM(s)/SUBSECTION(s): 21.7.2

IRM 21.7.2.4.4(3) Revised handling in seventh row of the table.

(3) When working a loose Form 8974, review the document and research the tax account for which it was filed to determine if the credit claimed was already processed or if there is another case document to which it should be associated (e.g., a Form 941-X case). Continue processing as follows:

If	And	Then
The loose Form 8974 was filed for an employment tax return period beginning before April 1, 2017 for Form 941 or before January 1, 2017 for Form 943 and Form 944.		Contact the IRM author through your management chain and the site P&A Staff for guidance on handling the case.
The original employment tax return has not posted	The taxpayer does not have employment tax filing requirements	Reject the Form 8974 with Letter 916C. Advise the taxpayer in the letter that we cannot consider their Form 8974 because the credit must be taken on an original employment tax return and it does not appear that they file employment tax returns.
The original employment tax return has not posted	There is a TC 150 pending on the account in open reject status and it appears the loose Form 8974 was submitted in response to (or is related to) the reject condition	Close the case and route the Form 8974 to ERS as appropriate.
The original employment tax return	Normal processing time for the original employment tax return	Monitor the account for posting of the return or until normal processing time is elapsed.

has not posted	has not elapsed	
The original employment tax return has not posted	Normal processing time for the original employment tax return has elapsed	<p>Reject the Form 8974 using Letter 4384C and inform the taxpayer they must file the appropriate original employment tax return with Form 8974 attached to claim the credit.</p> <p>Note: If the Form 8974 is missing information that would be required for its processing (see (4) in IRM 21.7.2.5.28.1, <i>Processing Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities</i>, for required verification items), identify the specific items requiring perfection in the rejection letter.</p>
The amount of QSB Research Credit claimed on the loose Form 8974 is equal to the amount of credit previously allowed for the tax period identified.		<p>If the Form 8974 was submitted in response to a missing information request on a previous Form 94XX case, take action to associate the new case to the previous case. Otherwise, take no further action and close the case.</p>
The loose Form 8974 reflects a decrease to a previously allowed credit amount (i.e., would result in a tax increase)		<ol style="list-style-type: none"> 1. Input a TC 290 adjustment in Blocking Series 15 for the amount of the QSB Research Credit change along with IRN 119 (for the same amount but as a negative). If appropriate, adjust the FTD penalty (see IRM 20.1.4.21.3, <i>Amended or Supplemental Return (Tax Decrease or Non-Interest-Free Tax Increase)</i>). 2. Issue Letter 4384C stating we processed the Form 8974 but that in the future changes to previously reported QSB Research Credit amounts must be corrected by filing an amended return (specify form) with Form 8974 attached. <p>Exception: # [REDACTED]</p>

		<p>#</p> <p>Exception: #</p> <p>#</p>
The loose Form 8974 reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e., would result in tax decrease)	The loose Form 8974 is a late response to a Letter 21C requesting a missing Form 8974 in support of a QSB Research Credit entry on an original employment tax return which was subsequently disallowed during pipeline processing	<ul style="list-style-type: none"> • Treat the issue as a substantiated math error response and allow the amount claimed (not to exceed the amount requested on the original return) so long as the Form 8974 is complete for processing. (see (4) in IRM 21.7.2.5.28.1, <i>Processing Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities</i>, for required verification items. • Input a TC 291 adjustment in Blocking Series 15 for the amount of the QSB Research Credit change along with IRN 119 (for the same amount but as a positive).
The loose Form 8974 reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e., would result in tax decrease)	#	<ul style="list-style-type: none"> • Input a TC 291 adjustment in Blocking Series 15 along with IRN 119 (for the same amount but as a positive) to allow the credit. • Issue Letter 4384C stating we processed the Form 8974 but that in the future changes to previously reported QSB Research Credit amounts must be corrected by filing the appropriate X form (specify form) with Form 8974 attached.
The loose Form 8974 reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e., would result in tax decrease)	#	<p>Reject the Form 8974 using Letter 4384C and inform the taxpayer they must file the appropriate X form (identify the specific form to be used) to make the adjustment.</p> <p>Note: If the Form 8974 is missing information that would be required for processing (see (4) in IRM</p>

		21.7.2.5.28.1, <i>Processing Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities</i> , for required verification items), identify the specific items requiring perfection in the letter.
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Caution: When rejecting documents, extreme care must be taken to ensure that only the material relative to the taxpayer(s) to which the correspondence is addressed is enclosed in the envelope. See IRM 21.3.3.4.25, *Breaches of Personally Identifiable Information (PII) Caused by Manual Stuffing Errors*, for additional information.

IRM 21.7.2.5.28 Revised to reflect changes to the QSB Research Credit arising from the Inflation Reduction Act of 2022.

(1) Section 121(a) of the Protecting Americans from Tax Hikes (PATH) Act of 2015, Division Q of P.L. 114-113 permanently extended the Credit for Increasing Research Activities. This non-refundable credit is generally used to reduce federal income tax liability and is claimed by completing Form 6765, *Credit for Increasing Research Activities*, and Form 3800, *General Business Credit*, which are attached to an income tax return.

Note: See IRM 21.7.4.4.8.3.5, *Form 6765, Credit for Increasing Research Activities*, for information on processing claims for the credit on income tax returns.

(2) Section 121(c) of the PATH Act added IRC Section 41(h) and IRC Section 3111(f) which allow certain qualified small businesses to apply a portion of the income tax credit for increasing research activities as a payroll tax credit against the employer's portion of social security tax.

- The payroll tax credit is in lieu of an income tax credit and is a non-refundable credit (i.e., reduces tax liability).
- Qualified small businesses elect the payroll tax credit on Form 6765 filed with a timely filed (including extensions) original income tax return. Once made, the election may only be revoked with the consent of the IRS.
- Qualified small businesses may make the election on Form 6765 for no more than five tax years.
- For tax years beginning after December 31, 2015 and before January 1, 2023, employers may elect to apply up to \$250,000 for each eligible income tax period against employer's share of social security taxes reported on one or more specified employment tax returns (i.e., until the credit is fully utilized).

Note: For ease of reference, the "Qualified Small Business Payroll Tax Credit for Increasing Research Activities" is generally referred to as the "QSB Research

Credit" throughout this IRM.

(3) Section 13902 of P.L. 117-169, the Inflation Reduction Act of 2022, increased and modified the QSB Research Credit.

- For tax years beginning after December 31, 2022, the maximum amount for which an election can be made on Form 6765 was increased to \$500,000.
- Starting in the first quarter of 2023, the payroll tax credit is first used to reduce the employer's share of social security tax up to \$250,000 per quarter and any remaining credit reduces the employer's share of Medicare tax for the quarter. (Credit amounts so applied may include election amounts arising from income tax returns filed for tax years beginning before January 1, 2023.) Any remaining credit, after reducing the employer's share of social security tax and the employer's share of Medicare tax, is then carried forward to the next quarter.

(4) Form 8974, *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, is used by taxpayers to compute the amount of QSB Research Credit that they are eligible to claim on an employment tax return for a particular tax period after accounting (in Part 1) for any credits claimed on previously filed employment tax returns. Form 8974 must be attached as supporting documentation to any original employment tax return on which the credit is claimed and to any Form 94XX filed to claim or adjust a QSB Research Credit.

Note: Companies filing aggregate employment tax returns (e.g., IRC 3504 agents, etc.) are required to attach a Form 8974 for each client taking the QSB Research Credit.

(5) An eligible taxpayer must file their income tax return with Form 6765 attached reflecting the binding election **before** they can claim the QSB Research Credit on an employment tax return with Form 8974. The QSB Research Credit can then be claimed starting with the first employment tax return filed reporting wages and tax for a calendar quarter beginning **after** the income tax return was filed.

Example: On March 10, 2022, a taxpayer files their Form 1120 for calendar year 2021 with Form 6765 attached reflecting an election to claim an amount for the QSB Research Credit on their employment tax returns. The taxpayer files quarterly Form 941 to report employment taxes. The taxpayer may first claim the QSB Research Credit on their Form 941 for the second quarter of 2022 since that tax period begins April 1, 2022 which is after the filing date of the income tax return.

Example: On July 15, 2022, a taxpayer files their Form 1120 for calendar year 2021 with Form 6765 attached reflecting an election to claim an amount for the QSB Research Credit on their employment tax returns. The taxpayer files quarterly Form 941 to report employment taxes. The taxpayer may first claim the QSB Research Credit on their Form 941 for the fourth quarter of 2022 since that tax period begins October 1, 2022 which is after the filing date of the income tax return.

Example: On August 5, 2022, a taxpayer files their Form 1120 for calendar year 2021 with Form 6765 attached reflecting an election to claim an amount for the QSB Research Credit on their employment tax returns. The taxpayer files annual Form 943 to report employment taxes. The taxpayer may first claim the QSB Research Credit on their Form 943 for calendar year 2022 since that return includes the fourth calendar quarter of 2021 which begins after the filing date of the income tax return.

Example: On November 3, 2022, a taxpayer files their Form 1120 for calendar year 2021 with Form 6765 attached reflecting an election to claim an amount for the QSB Research Credit on their employment tax returns. The taxpayer files annual Form 944 to report employment taxes. Since the Form 1120 was filed during the last calendar quarter of 2022, the taxpayer may first claim the QSB Research Credit on their Form 944 for calendar year 2023.

Note: The first full calendar year income tax return on which an eligible taxpayer could make an election to claim the QSB Research Credit against employment taxes was 2016.

(6) Credit limitations:

- For tax years beginning before January 1, 2023, the maximum amount of research credit for which an election could be made on Form 6765 to be applied against employment tax returns was \$250,000 per tax year (i.e., on the income tax return side). However, the only limitation on the amount of the credit so elected that could be taken on a particular associated employment tax return filed for tax periods beginning before January 1, 2023 was the employer's share of social security tax. So, the credit taken on a particular employment tax return could exceed \$250,000 if the taxpayer was applying credits from multiple elections, either due to carrying forward credits that could not be previously fully utilized or in the filing of an aggregate employment tax return filer.
- For tax years beginning after December 31, 2022, the election that can be taken on the income tax return with Form 6765 was increased to \$500,000. However, changes to how the credit is applied against employment tax returns were effective with the first calendar quarter of 2023, including for amounts arising from earlier tax years which had not been fully utilized. Up to \$250,000 of the election amount(s) may be applied to the employer's share of social security tax reported for a particular employment tax period, the remainder is then applied against the employer's share of Medicare taxes for a particular employment tax period, and any amounts remaining thereafter may be carried forward until fully utilized.

(7) Most questions from employers about the QSB Research Credit (including questions about elections, credit limitations, and how the credit is applied against employment taxes) can be resolved by directing the employer to the forms, form instructions, or Notice 2017-23. Employers can also be directed to related information on the [irs.gov](https://www.irs.gov) website at Qualified Small Business Payroll Tax Credit for Increasing Research Activities:

(8) For Form 8974 handling guidance:

- See IRM 21.7.2.5.28.1, *Processing Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, for guidance on processing Form 8974 filed with a Form 94XX.
- See IRM 21.7.2.5.28.2, *Form 94XX Claiming QSB Research Credit — Missing Form 8974*, for guidance on processing Forms 94XX reporting changes to QSB Research Credits without Form 8974 attached.
- See IRM 21.7.2.4.4.4, *Loose Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, for guidance on handling loose Forms 8974.

IRM 21.7.2.5.28.1 Revised to reflect Form 8974 processing changes arising from the Inflation Reduction Act of 2022.

(1) This subsection provides specialized handling guidance for Form 8974 attached to a Form 94XX or to a duplicate filed employment tax return being processed as a Form 94XX. All other Form 94XX processing guidelines and requirements also apply to Forms 94XX with Form 8974 attached.

Note: For Form 94XX cases with missing Form 8974, see IRM 21.7.2.5.28.2, *Form 94XX Claiming QSB Research Credit — Missing Form 8974*.

Note: For loose Form 8974 cases, see IRM 21.7.2.4.4.4, *Loose Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*.

(2) IRN 119 is used along with TC 290, TC 291, or TC 298 (as appropriate) to record adjustments to the QSB Research Credit on Form 941, Form 943, and Form 944 tax accounts.

- IRN 119 is valid for Form 941 (tax period 201706 and subsequent), Form 943 (tax period 201712 and subsequent), and Form 944 (tax period 201712 and subsequent).
- An increase to the credit will be recorded with a positive IRN 119 amount and a corresponding decrease to tax (i.e., a TC 291 for the same amount if no other changes were reported).
- A decrease to the credit will be recorded with a negative IRN 119 amount and a corresponding increase to tax (i.e., a TC 290/298 for the same amount if no other changes were reported).

Example: A Form 941-X is filed with Form 8974 attached claiming an increase to the QSB Research Credit in the amount of \$75. Assuming all processing requirements are met, the adjustment to be made would be a TC 291 for \$75.00- and an IRN 119 for \$75.00.

Example: A Form 941-X is filed with Form 8974 attached reporting a decrease to the QSB Research Credit in the amount of \$90. Assuming all processing requirements are met, the adjustment to be made would be a TC 290 (or TC 298 as applicable) for \$90.00 and an IRN 119 for \$90.00-.

Example: A Form 941-X is filed with Form 8974 attached claiming an increase to the QSB Research Credit in the amount of \$50. The Form 941-X also reports social security and Medicare wage increases of \$1,000 each and a corresponding increase to social security and Medicare taxes in the amount of \$153.00. Assuming all processing requirements are met, the adjustment to be made would be a TC 290 (or TC 298 as applicable) for \$103.00, an IRN 004 for \$1,000.00, an IRN 073 for \$1,000, an IRN 112 for \$153.00 and an IRN 119 for \$50.00.

Note: IRN 119 can be combined on Command Code ADJ54 adjustments with any other IRN valid for the form being adjusted.

(3) An increase to the credit (i.e., decrease to tax) may meet examination criteria. See Exhibit 21.5.3-2, *Examination Criteria (CAT-A) — General*.

Note: #

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(4) In addition to all other verification requirements applicable to the Form 94XX (or original tax return) to which a Form 8974 is attached, the following items are required to be verified on Form 8974 prior to processing:

1. Verify a name and EIN were entered in entity section of Form 8974.

Note: Companies filing aggregate employment tax returns (e.g., IRC 3504 agents, etc.) are required to file a Form 8974 for each client taking a QSB Research Credit. So, there may be multiple Forms 8974 attached to a single Form 94XX and these Forms 8974 may reflect the client's information in the entity section of Form 8974 rather than that of the company under whose EIN the QSB Research Credit is being claimed.

2. Verify the taxpayer claiming the QSB credit has filing requirements for the type of employment tax return identified on Form 8974. If the taxpayer does not have employment tax filing requirements, use Letter 4384C to reject the Form 94XX and Form 8974 and inform the taxpayer in the letter that we cannot consider the requested changes since our records indicate they do not file employment tax returns.
3. Verify the taxpayer filed an original employment tax return for the calendar year and quarter (if applicable) being corrected. If the taxpayer has employment tax filing requirements but no return is posted, see IRM 21.7.2.4.6.6, *Adjusted Employer's Tax Return or Claim for Refund Return Filed — No TC 150 Posted*, for handling guidance.

Caution: If the QSB Research Credit is being filed for an employment tax return period beginning earlier than April 1, 2017 for Form 941 or earlier than January 1, 2017 for Form 943 and Form 944, contact the IRM author through your management chain and the site P&A Staff for guidance on handling the case.

4. Verify the taxpayer filed the correct version of Form 8974 for the tax period under consideration.
 - Adjustment requests filed for tax periods 202212 and prior must be filed with Form 8974 having a revision date of December 2017.
 - Adjustment requests filed for tax periods 202303 and subsequent must be filed with a Form 8974 having a revision date of March 2023 or later.
 - If the taxpayer filed the adjustment request with an incorrect Form 8974 version, use Letter 4384C to reject the Form 94XX and Form 8974 and inform the taxpayer in the letter that we cannot consider the requested changes because the incorrect Form 8974 version was submitted.
5. Verify the taxpayer identified in Part 1 of Form 8974 has filed an original income tax return for the specified form type and tax period.

Note: #

[REDACTED] #

a) If there is more than one Form 8974 attached to the Form 94XX, or if multiple EINs are listed in Part 1 of Form 8974, or if there is a single EIN listed in Part 1 of Form 8974 and it does not match the EIN on the Form 94XX, #

[REDACTED] # .

b) If more than one income tax return is listed in Part 1 of Form 8974 (all with the same EIN), #

[REDACTED] # .

c) If the taxpayer identified in Part 1 of Form 8974 does not file Form 1040, Form 1065, Form 1120, Form 1120-F, or Form 1120S income tax returns, they are **not** eligible to claim the QSB Research Credit. If the taxpayer enters an income tax return other than one of those specified (or its corresponding amended income tax form), or research shows they file an income tax return other than one printed on Line 1 of Form 8974, reject the claim with Letter 916C. Advise the taxpayer in the letter that we cannot consider the amount claimed on their Form 8974 because our records show their organization type is not eligible to claim the QSB Research Credit.

d) If the income tax return has not posted and the date entered on Line 3 of Form 8974 is less than 30 days prior to the received date of the Form 8974, suspend the case for 40 days and monitor for posting of the income tax return. If the return posts, continue to process as appropriate.

e) If the date entered is 30 days or more from the received date of the Form

8974, or the suspense period has passed and no income tax return is posted, follow the instructions in (5) below to reject the Form 94XX and Form 8974 with instructions to refile their QSB Research Credit claim after they file their income tax return.

6. Verify the Form 8974 has been filed for an employment tax period covering a calendar quarter that began **after** the income tax return identified in Part 1 of Form 8974 was filed. See (5) in IRM 21.7.2.5.28, *Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, for guidance. If the Form 8974 was filed for an employment tax period before what is permitted based on when the identified income tax return was filed, follow procedures in IRM 21.5.3.4.6.3, *No Consideration Procedures* and instruct the taxpayer to refile their QSB Research Credit claim for the appropriate tax period.

Reminder: # [REDACTED]

[REDACTED] #

Caution: For timely filed returns, TXMOD and BMFOL return received dates fields reflect the associated return due date rather than the actual filing date. In some cases, it may be necessary to review MeF to verify the true filing date of the income tax return (if filed electronically) to verify the Form 8974 has been filed for a correct employment tax return period. # [REDACTED]

[REDACTED] #

7. Continue processing the Form 8974 as per instructions below in (5) or (6) based on the tax period for which the filing was made.

(5) Math verification of Forms 8974 filed for tax periods 202212 and earlier:

- a. Verify the figures reported on Line 8 and Line 9 in Part 2 of Form 8974 agree with the amounts on the corresponding lines of the Form 94XX (or employment tax return) **and** math verify Lines 8 through 11 of Form 8974 to ensure the amount of QSB Research Credit claimed does not exceed the employee's share of social security tax.

Exception: # [REDACTED]

[REDACTED] #

Exception: # [REDACTED]

[REDACTED] #

- b. Verify the figure reported on Line 12 of Form 8974 is the lesser of the entry on Line 7 or the math verified amount for 11 and agrees with the amount reported for the QSB Research Credit claimed on the corresponding line of the Form 94XX (or employment tax return). If the Line 12 entry, or the corresponding figure on the Form 94XX (or employment tax return), exceeds the lesser of the Line 7 or verified Line 11 amounts # [REDACTED] #, the amount to be allowed is the lesser of the Line 7 or verified Line 11 amounts.

Note: If the amount to be recorded for the credit is less than the taxpayer's entry on Line 12 of Form 8974 or the corresponding line of the Form 94XX (or employment tax return), follow partial disallowance procedures in IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures*, including issuing the appropriate Letter 106C.

(6) Math verification of Forms 8974 filed for tax periods 202303 and later:

- a. Verify the figures reported on Line 8 and Line 9 in Part 2 of Form 8974 agree with the amounts on the corresponding lines of the Form 94XX (or employment tax return) **and** math verify Lines 8 through 11 of Form 8974 to ensure the amount of QSB Research Credit claimed does not exceed the employer's share of social security tax.

Exception: # [REDACTED] #

Exception: # [REDACTED]

[REDACTED] #

- b. Verify the figure reported on Line 12 of Form 8974 is the lesser of the entry on Line 7, the math verified amount for 11, or \$250,000.
- c. Math verify the figure reported on Line 13 of Form 8974 by subtracting the verified figure for Line 12 (from Step b above) from the taxpayer entry on Line 7 of Form 8974.
- d. Verify the figure reported on Line 14 in Part 2 of Form 8974 agrees with the amount on the corresponding line of the Form 94XX (or employment tax return) **and** math verify Lines 14 and 15 of Form 8974 to ensure the amount of QSB Research Credit claimed does not exceed the employer's share of Medicare tax.

Reminder: # [REDACTED] #

- e. Verify the figure reported on Line 16 of Form 8974 is the lesser of the entry on Line 15 or the math verified amount for 13 (from Step c above).
- f. Math verify Line 17 of Form by adding the math verified figures for Line 12 and Line 16 of Form 8974. This is the amount of QSB research credit to be recorded as per guidance in (7) and (8) below.

Exception: # [REDACTED] #

Reminder: # [REDACTED] #

Note: If the amount to be recorded for the credit is less than the taxpayer's entry on Line 17 of Form 8974 or the corresponding line of the Form 94XX (or employment tax return), follow partial disallowance procedures in IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures*, including issuing the appropriate Letter 106C.

(7) If any information required to be verified on the Form 8974 is missing # [REDACTED] #, make two attempts to secure the information by phone if a telephone number is available. Otherwise, follow procedures in IRM 21.5.3.4.2, *Tax Decrease or Credit Increase Processing*. Use Letter 4384C to reject the claim and identify the missing information in the letter. When rejecting the Form 94XX, follow IRM 21.5.3.4.2, *Tax Decrease or Credit Increase Processing*, and (9) in IRM 21.5.1.5.6, *Incomplete CIS claims*, for the correct input of TC 971-270 and release of the applicable freeze code (use Blocking Series 20 if inputting a TC 290 .00 to release the -A freeze in this situation).

Exception: Do not contact the taxpayer to request a missing income tax return. Address missing income tax returns as per a), b), c), d), and e) in Step 5 in (4) above.

Caution: The individual contacted by phone must be authorized to prepare taxpayer's employment tax returns. Document the case history with the date, time, name of individual contacted, and information obtained from the individual.

(8) After applying the verification procedures (as appropriate) in (4), (5), (6), and (7) above, continue processing complete QSB Research Credit claims and requests for adjustment as per the general procedures in IRM 21.7.2.4.6, *Adjusted Employer's Federal Tax Return or Claim for Refund*, and the specific procedures applicable to the type of Form 94XX filed (e.g., for a tax decrease - claim for refund filed on Form 941-X, follow IRM 21.7.2.4.7.6.2, *Form 941-X Tax Decrease — Claim*). Record any changes to the QSB Research credit with IRN 119 as appropriate per guidance in (2) above.

Exception: If the Form 8974 is attached to an original return filed in response to a 6020(b) assessment, continue processing per handling guidance in IRM 21.7.9.4.1.6, *Duplicate Filing Conditions Involving Returns Prepared Under IRC Section 6020(b)*.

Reminder: Credit limitations are discussed in (10) of IRM 21.7.2.5.28, *Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*. #

[Redacted]