

## IRM PROCEDURAL UPDATE

**DATE:** 07/19/2017

**NUMBER:** wi-21-0717-1165

**SUBJECT:** Form 8974 Processing

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

**CHANGE(s):**

**IRM 21.7.2.4.4.4(3) Added row to table to address situations where related original returns have not filed. Also, added exception in row discussing forms reflecting increases to previously processed credits.**

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:

| <b>If</b>  | <b>Then</b>  |
|--|--|
| 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  | If normal processing time for the original employment tax return has elapsed, reject the Form 8974 using Letter 4384C and inform the taxpayer they must file the appropriate original employment with Form 8974 attached to claim the credit. Otherwise, monitor the account for posting of the return or until normal processing time is elapsed and take the appropriate action.<br><br><b>EXCEPTION:</b> If there is a TC 150 pending on the account in open reject status and it appears the loose Form 8974 submitted is in response to (or related to) the reject condition, close the case and route the Form 8974 to ERS as appropriate. |

|   |  |
|---|--|
|   | <p><b>NOTE:</b> If rejecting a Form 8974 that is missing information required for its processing (see (10) in IRM 21.7.2.5.28, <i>Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities</i>), identify the specific items requiring perfection in the rejection letter.</p>  |
| <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>    | <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, no action is needed.</p>   |
| <p>The loose Form 8974 reflects a decrease to a previously allowed credit amount (i.e. would result in a tax increase)</p>                                    | <ol style="list-style-type: none"> <li>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 (Tax Decrease or Non-Interest-Free Tax Increase)</i>).</li> <li>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.</li> </ol> <p># [REDACTED]</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)</p> | <p>Reject the Form 8974 using Letter 4384C and inform the taxpayer they must file the appropriate <b>X</b> form (identify the specific form to be used) to make the adjustment.</p> <p><b>NOTE:</b> If the Form 8974 is missing information that would be required for processing (see (10) in IRM 21.7.2.5.28,</p>  |

*Form 8974, Qualified Small Business Payroll Tax Credit for Increasing Research Activities*), identify the specific items requiring perfection in the letter.



**EXCEPTION:** If 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, 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. 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).

**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 Clarified procedures for several filing scenarios.

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. See IRM 21.7.4.4.8.3.4, *Form 6765, Credit for Increasing Research Activities*, for more information.
2. Section 121(c) of the Act also added IRC Section 41(h) and IRC Section 3111(f) which allow qualified small businesses to elect to claim a portion of the income tax credit for increasing research activities as a payroll tax credit against the employer portion of social security tax. The payroll tax credit is in lieu of an income tax credit and is also non-refundable. Qualified small businesses elect the payroll tax credit on Form 6765. Once made, the election may only be revoked with the consent of the IRS.

**NOTE:** For ease of reference, the "Qualified Small Business Payroll Tax Credit for Increasing Research Activities" will generally be referred to as the "QSB Research Credit" throughout this IRM.

**NOTE:** Most taxpayer questions about the QSB Research Credit can be resolved by directing the taxpayer to the forms, form instructions, or Notice 2017-23.

3. Form 8974, *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, was created to enable 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. 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:** See IRM 21.7.2.4.4.4, for guidance on handling loose Forms 8974.

4. 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, 2017, a taxpayer files their Form 1120 for calendar year 2016 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 2017 since that tax period begins April 1, 2017 which is after the filing date of the income tax return.

**EXAMPLE:** On July 17, 2017, a taxpayer files their Form 1120 for calendar year 2016 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 2017 since that tax period begins October 1, 2017 which is after the filing date of the income tax return.

**EXAMPLE:** On August 6, 2017, a taxpayer files their Form 1120 for calendar year 2016 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 2017 since that return includes the fourth calendar quarter of 2017 which begins after the filing date of the income tax return.

**EXAMPLE:** On November 3, 2017, a taxpayer files their Form 1120 for calendar year 2016 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 2017, the taxpayer may first claim the QSB Research Credit on their Form 944 for calendar year 2018.

5. 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. Due to the timing of the required filings (see (4) above), the earliest those taxpayers could claim the QSB Research Credit on an employment tax return will be a Form 941 filed for the second quarter of 2017. Computer functionality and the handling procedures which follow are based on that standard filing scenario. However, there are some less common filing scenarios where an eligible taxpayer could in fact claim the QSB Research Credit against the employer's share of social security tax for a period earlier than the second quarter of 2017. Accordingly, if a claim (on an employment tax return, Form 94XX, Form 843, loose Form 8974, or correspondence) for the QSB Research Credit is received in Accounts Management for an employment tax return period beginning earlier than April 1, 2017 for Form 941 or 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.
6. The QSB Research Credit as applied to employment taxes is a non-refundable credit taken against the employer's share of social security taxes.

#



#

7. Because the QSB Research Credit that can be claimed on any particular tax period is limited to the employer's share of social security taxes, some taxpayers may not be able to fully utilize the total QSB Research Credit to which they are entitled on a single employment tax return period. Such taxpayers will be able to carry any unused QSB Research Credit to succeeding tax periods. Accordingly, Lines 6 and 7 of Form 8974 are used by the taxpayer to report previously claimed and remaining available QSB Research Credit amounts.
8. IRN 119 will be validated for Form 941 (tax period 201706 and subsequent), Form 943 (tax period 201712 and subsequent), and Form 944 (tax period 201712 and subsequent) to record adjustments to the QSB Research Credit. IRN 119 will be able to be combined on Command Code ADJ54 adjustments with any other valid IRN for those forms.
  - o 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).
  - o 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.

9. 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*.

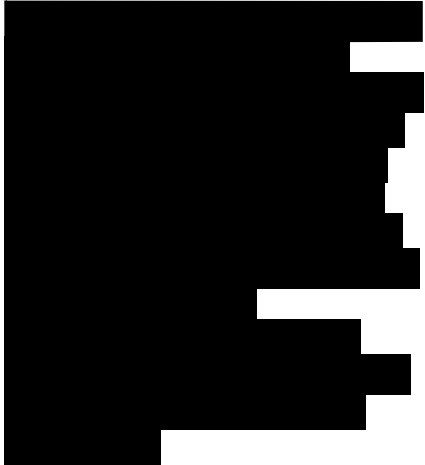




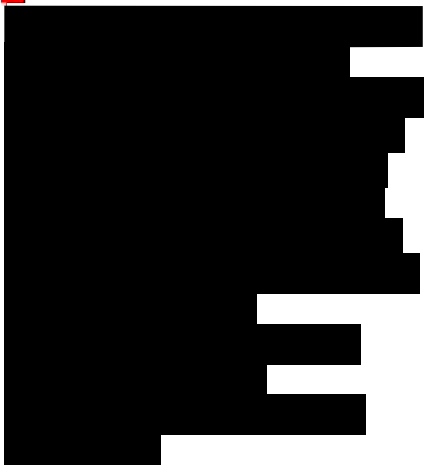
10. On occasion, a taxpayer may submit a Form 94XX (or employment tax return) with an entry for the QSB Research Credit but fail to attach Form 8974 as required. Handle missing Form 8974 situations as follows:

| If  | And | Then  |
|---|-----|---|
| The entry on Form 94XX (or employment tax return) is equal to the amount of credit previously allowed for the tax period identified.              |     | A Form 8974 is not required. Continue to process the Form 94XX (or employment tax return) as appropriate.   |
| The entry on Form 94XX (or employment tax return) reflects a decrease to a previously allowed credit amount (i.e. would result in a tax increase) |     | <ol style="list-style-type: none"> <li>1. Continue to process the Form 94XX (or employment tax return) as appropriate and complete the change to the QSB Research Credit as requested if all other requirements are met.</li> <li>2. Close the case and issue Letter 4384C stating we processed the adjustment requested on their Form 94XX but that the required Form 8974 was not attached. Instruct the taxpayer to submit the missing Form 8974.</li> </ol> |

|   |  |  |
|---|--|--|
|   |  | <p>#</p>  <p>#</p> <p><b>NOTE:</b> A taxpayer response with the missing Form 8974 will be treated as a new case.</p>   |
| <p>The entry on Form 94XX (or employment tax return) reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e. would result in tax decrease)</p> | <p>The Form 94XX (or employment tax return) also reflects other tax changes which, considered on their own, would result in a net tax decrease</p> | <ol style="list-style-type: none"> <li>1. Make two attempts to secure the missing Form 8974 by phone if a telephone number is available. If the missing Form 8974 is secured, continue processing as per instructions in (11), (12) and (13) below. Otherwise, if there is no telephone number, or there was and efforts to secure the missing Form 8974 via phone were unsuccessful, go to step 2) immediately below.</li> <li>2. Continue to process the other changes reported Form 94XX (or employment tax return) as appropriate but <b>do not</b> allow the requested change to the QSB Research Credit.</li> <li>3. Follow partial disallowance procedures in IRM 21.5.3.4.6.1, <i>Disallowance and Partial Disallowance Procedures</i>, including issuing the appropriate Letter 106C. Advise the taxpayer that we processed the other changes requested but could not allow the QSB Research</li> </ol> |



|   |  |   |
|---|--|---|
|   |  | <p>Credit change because the required Form 8974 was not attached.</p> <p>#</p>  <p>#</p>  |
| <p>The entry on Form 94XX (or employment tax return) reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e. would result in tax decrease)</p> | <p>The Form 94XX (or employment tax return) also reflects other tax changes which, considered on their own, would result in a net tax increase</p> | <p>1. Continue to process the other changes reported Form 94XX (or employment tax return) as appropriate but <b>do not</b> allow the requested change to the QSB Research Credit.</p> <p>2. Issue Letter 4384C. Advise the taxpayer that we processed the other changes requested but could not allow the QSB Research Credit change because the required Form 8974 was not attached.</p> <p>#</p>  |

|   |   |   |
|---|---|---|
|   |   |   |
| <p>The entry on Form 94XX (or employment tax return) reflects an increase to a previously allowed credit amount or no credit was previously claimed (i.e. would result in tax decrease)</p> | <p>The change to the QSB Research Credit is the <b>only</b> correction being made</p> | <p>#</p> <ol style="list-style-type: none"> <li>1. Make two attempts to secure the missing Form 8974 by phone if a telephone number is available. If the missing Form 8974 is secured, continue processing as per instructions in (11), (12) and (13) below. Otherwise, if there is no telephone number, or there was and efforts to secure the missing Form 8974 via phone were unsuccessful, go to step 2) immediately below.</li> <li>2. Reject the Form 94XX using Letter 4384C. Inform the taxpayer Form 8974 must be attached to their Form 94XX (specify form) when changes are requested to amounts of QSB Research Credit claimed.</li> </ol> <p>#</p>  <p>#</p> |

**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.

11. 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. Name, address, and EIN.
  2. Type of employment tax return being corrected.
  3. Calendar year and quarter (if applicable) being corrected.
  4. Verify the income tax return identified by the taxpayer in Part 1 of Form 8974 has been filed.

**NOTE:** 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. 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 (12) 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.

**CAUTION:** If the taxpayer does not file one of the income tax returns printed on Line 1 of Form 8974, they are **not** eligible to claim the QSB Research Credit. If the taxpayer enters an income tax return other than one printed on Line 1 of Form 8974, 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.

5. 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 (4) above for guidance.

**NOTE:** 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.

**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]

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

#

[REDACTED]

#

8. 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] #, only the verified amount is to be allowed.

**NOTE:** In this situation, it will be necessary to follow partial disallowance procedures in IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures*, including issuing the appropriate Letter 106C.

12. If any information required to be verified on the Form 8974 is missing # [REDACTED]

[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.

**EXCEPTION:** Do not contact the taxpayer to request a missing income tax return. See the Note after Step 4 in (11) 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.

13. After applying the verification procedures in (11) and (12) above, continue processing complete QSB Research Credit claims and requests for adjustment as per the general procedures in IRM 21.7.2.4.6 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*).

**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:** See IRM 21.7.2.4.4.4, for guidance on handling loose Forms 8974.