



# Instructions for Form 6765

## Credit for Increasing Research Activities (or for claiming the orphan drug credit)

(Section references are to the Internal Revenue Code unless otherwise noted.)

### Items You Should Note

- The Revenue Reconciliation Act of 1990 extended the credit for increasing research activities and the orphan drug credit through December 31, 1991.

- For tax years beginning after December 31, 1989, the credit for increasing research activities is allowed for in-house research expenses paid or incurred by new businesses or by existing businesses that are entering new trades or businesses. To be eligible for the credit in these cases, the principal purpose of the taxpayer in making these expenditures must be to use the results of the research in the active conduct of a future trade or business. See section 41(b)(4).

- For tax years beginning after December 31, 1989, you may not deduct qualified research expenses or basic research expenses except to the extent such expenses exceed the credit for increasing research activities for the tax year. However, you may claim a full deduction for these expenses if you elect to take a reduced credit on line 26. See section 280C(c) and instructions for line 26.

- The Part III computation of the current year credit has been revised. For 1990, the 20% credit for qualified research expenses is allowed to the extent that qualified expenditures exceed the base amount figured on lines 19, 20, and 21. See the instructions for Part III for other changes.

### General Instructions

**Purpose of Form.**—Use Form 6765 to figure and claim the general business credit for increasing the research activities of a trade or business and to claim the orphan drug credit. Complete Parts II, III, and IV (or Form 3800) to figure the research credit. Complete Parts I and II to figure the orphan drug credit.

**Definitions.**—*Qualified research* is limited to scientific experimentation or engineering activities designed to aid in the development of a new or improved product, process, technique, formula, invention, or computer software program held for sale, lease, or license, or used by you in a trade or business. In the case of in-house research expenses

(see section 41(b)(2)), this trade or business requirement will be met if your principal purpose for conducting the research is to use the results of the research in the active conduct of a future trade or business. See section 41(b)(4).

The research credit is generally **not** allowed for the following types of activities:

- Research conducted after the beginning of commercial production;
- Research adapting an existing product or process to a particular customer's need;
- Duplication of an existing product or process;
- Surveys or studies;
- Research relating to certain internal-use computer software;
- Research conducted outside the U.S.;
- Research in the social sciences, arts, or humanities; or
- Research funded by another person (or governmental entity).

See section 41 for more details and rules.

If you incur qualified clinical testing expenses relating to drugs for certain rare diseases, you may elect to claim a 50% credit on these expenses instead of taking the research credit.

*The orphan drug credit* is an elective tax credit available for 50% of qualified clinical testing expenses of low or unprofitable drugs for rare diseases and conditions, as designated under Section 526 of the Federal Food, Drug, and Cosmetic Act, paid or incurred during the tax year. For additional information, see Regs. section 1.28-1.

The orphan drug credit is similar to the credit under section 41 for qualified research expenditures, except that clinical testing expenses are not limited to 65% of any contract research expenses, there is no requirement that expenses exceed those for a base period, and the expenditure must be for "qualified clinical testing" as defined in sections 28(b)(1) and (2). Expenses that qualify under section 28 cannot also qualify for the research credit under section 41.

This credit is a nonrefundable credit that may not exceed the excess of:

(1) the regular tax reduced by the sum of the nonrefundable personal credits and the nonrefundable foreign tax credit, over (2) the tentative minimum tax.

Even though you cannot use the same expenses to claim both the research credit and the orphan drug credit, any expenses used in computing the orphan drug credit must be included in any research credit "base amount" computations in future years.

**Who Must File.**—An individual, estate, trust, organization or corporation claiming a credit for increasing research activities or for orphan drug expenses, or any S corporation, partnership, estate or trust that allocates the credit(s) to its shareholders, partners, or beneficiaries should attach this form to its income tax return.

S corporations, partnerships, estates, and trusts that allocate the credit(s) on lines 4 and 28 to any shareholder, partner, or beneficiary must show on the appropriate line of Schedule K-1, or on an attachment to Schedule K-1, the credit allocable for that shareholder, partner, or beneficiary.

### Special Rules

See section 41(f) for special rules related to:

- (1) Controlled groups of corporations and businesses under common control;
- (2) Allocation of the credit by partnerships, estates and trusts;
- (3) Adjustments if a major portion of a business is acquired or disposed of; and
- (4) Short tax years.

For special rules concerning the allocation and apportionment of research and experimental expenditures between U.S. and foreign source income, see sections 861 through 864.

**Carrybacks and Carryforwards.**—If you cannot use the research credit because of tax liability limitations, you may carry it back 3 years, then forward 15 years. Use Form 3800. There are no carryback or carryover provisions for the orphan drug credit.

See section 383 for the limitation on the amount of any excess general business tax credits of a loss corporation for any tax year ending after a post-1986 ownership change that may be used in a post-change year.

### Specific Instructions

#### Part I.—Tentative Orphan Drug Credit

**Line 2.**—You must reduce the deduction for qualified clinical testing expenses otherwise allowable on your income tax return by the amount of the credit shown on line 2. See section 280C(b) for special rules.

**Line 3.**—Enter the amount of credit that was allocated to you as a shareholder, partner, or beneficiary.

**Line 4.**—If you have credits from passive activities, see **Form 8582-CR**, Passive Activity Credit Limitations, or **Form 8810**, Corporate Passive Activity Loss and Credit Limitations, before completing the remainder of this form.

*Estates and trusts:* The orphan drug credit on line 4 is allocated between the estate or trust and the beneficiaries in the same proportion as income was allocated. On the dotted line to the left of the amount on line 4, the estate or trust should enter its share of the credit. Label it "1041 PORTION" and use this amount in Part II to figure the credit to take on Form 1041. On Schedule K-1 show the credit for each beneficiary.

*S corporations and partnerships:* Prorate the orphan drug credit on line 4 among the shareholders or partners. Attach Form 6765 to the return and on Schedule K-1 show the credit for each shareholder or partner

## Part II.—Computation of the Tax Liability Limitations for the Orphan Drug and Research Credits

**Line 10.**—Include the orphan drug credit on the appropriate line of your 1990 tax return. If it is not listed separately on the return, include the credit on the "other credits" or "total credits" line; then write "ORPHAN DRUG CREDIT" and the amount on the dotted line to the left of the entry amount.

## Part III.—Current Year Credit for Increasing Research Activities

**Line 11.**—Corporations (other than S corporations, personal holding companies, and service organizations) may be eligible for a "basic research" credit if your 1990 payments in cash to a qualified university or scientific research organization (pursuant to a written contract) exceed a base period amount (based on your general university giving and certain other maintenance-of-effort levels for the 3 preceding years). Enter your 1990 payments on line 11. See section 41(e) for details.

**Line 12.**—Enter the base period amount as defined in section 41(e). The amount on line 12 (but not more than the amount on line 11), although not eligible for the 1990 basic research credit, can be treated as 1990 contract research expenses on line 17, (and subject to the 65% limitation).

**Line 16.**—See section 41(b)(2)(A) for rules on leased property if you receive payments from anyone for the rental or lease of substantially identical property.

**Line 17.**—Include 65% of any amount paid or incurred for qualified research performed on your behalf. Prepaid contract research expenses are considered paid in the year the research is actually done. Also include 65% of that portion of the line 11 basic research payments which does not exceed the line 12 base amount. See section 41(e)(1)(B).

**Line 19.**—Compute the fixed-based percentage as follows:

**Existing firms.**—The fixed-base percentage is the ratio that the aggregate qualified research expenses for at least 3 tax years from 1984 to 1988 bears to the aggregate gross receipts for such tax years. Round off the percentage to the nearest 1/100th of 1%.

**Start-up companies.**—If there are fewer than 3 tax years between 1984 and 1988 in which the taxpayer had both gross receipts and qualified research expenses, the percentage is 3%. If the percentage computation involves de minimis amounts of gross receipts and qualified expenses in a tax year or short tax years are involved, see sections 41(c)(3) and 41(f)(4).

**Note:** The maximum percentage that can be entered on line 19 is 16%.

**Line 20.**—Enter on line 20 the average annual gross receipts for the 4 tax years preceding the tax year for which the credit is being determined (called the credit year). You may be required to annualize gross receipts for any short tax year. See sections 41(c)(1)(B) and 41(f)(4) for details.

For purposes of lines 19 and 20, gross receipts for any tax year shall be reduced by returns and allowances made during the tax year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the trade or business within the U.S.

**Line 23.**—The base amount cannot be less than 50% of the current year qualified research expenses. This rule applies both to existing and newly organized businesses.

**Line 26.**—If you do not elect the reduced credit, you must reduce your otherwise allowable deduction for qualified research expenses or basic research expenses by the amount of the credit on line 26. If the line 26

credit exceeds the amount allowed as a deduction for the tax year, reduce the amount chargeable to the capital account for the year for such expenses by the amount of the excess.

Attach a statement to your tax return that lists the deduction amounts (or capitalized expenses) that were reduced. Identify the lines of your return (schedule or forms for capitalized items) on which the reductions were made.

**Line 27.**—Enter the amount of credit that was allocated to you as a shareholder, partner, or beneficiary.

**Line 28.**—*Estates and trusts:* The research credit on line 28 is allocated between the estate or trust and the beneficiaries in the same proportion as income was allocated. On the dotted line to the left of the amount on line 28, the estate or trust should enter its share of the credit. Label it "1041 PORTION" and use this amount in Part IV (or on Form 3800) to figure the credit to take on Form 1041. On Schedule K-1 show the credit for each beneficiary.

*S corporations and partnerships:* Prorate the research credit on line 28 among the shareholders or partners. Attach Form 6765 to the return and on Schedule K-1 show the credit for each shareholder or partner

## Part IV.—Computation of Allowable Research Credit

**Line 31. Limitations.**—See section 38(c)(3) for special rules for married couples filing separate returns, for controlled corporate groups, and for estates and trusts.

**Line 34. Limits.**—If you are an individual, estate, or trust, the credit(s) on lines 26 or 27 is limited to the amount attributable to your interest in the proprietorship, partnership, S corporation, estate or trust generating the credit. Figure separately for each business enterprise by using the following formula:

$$\begin{array}{r} \text{Taxable income attributable to} \\ \text{your interest in the} \\ \text{unincorporated business,} \\ \text{1065, 1041, or 1120S entity} \\ \hline (\text{Line 30} - \text{line 31}) \times \text{Taxable income for the year} \\ \text{(Form 1040, line 37)} \end{array}$$

When using the formula, the result is limited to 100% of line 30 less line 31.

If in the current tax year you had no taxable income attributable to a particular business interest, you cannot claim any research credit this year for that business.