



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 To Note

- The orphan drug credit expires December 31, 1994, and the research credit expires June 30, 1995. Fiscal year filers, include only those payments and expenses paid or incurred by the expiration dates.
- Fiscal year filers with a tax year beginning before July 1, 1995, and ending after June 30, 1995, need to make a special computation for the base amount. See the instructions for line 21.

General Instructions

Purpose of Form

Use Form 6765 to figure and claim the credit for increasing research activities and the orphan drug credit. Complete Parts II, III, and IV (or Form 3800, if required) to figure the research credit. Complete Parts I and II to figure the orphan drug credit.

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 complete this form and attach it 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.

Definitions

Research credit.—The research credit is generally allowed for qualified research.

Qualified research means research for which expenditures may be treated as expenses under section 174. This research must be undertaken for discovering information that is technological in nature, and its application must be intended for use in developing a new or improved business

component of the taxpayer. In addition, this research is eligible for the credit only if substantially all of the activities of the research constitute a process of experimentation for a functional purpose, that is a new or improved function, performance, or reliability or quality.

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 United States.
- Research in the social sciences, arts, or humanities.
- Research funded by another person (or governmental entity).

If you incur qualified clinical testing expenses relating to drugs for certain rare diseases, you may elect to claim the orphan drug credit on these expenses instead of taking the research credit. See section 28.

See section 41 for other definitions and special rules concerning the research credit.

Orphan drug credit.—This is an elective tax credit available for 50% of qualified clinical testing expenses of low-profit 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 details, see Regulations section 1.28-1.

Like the research credit under section 41, the orphan drug credit applies to certain in-house and contract expenses. However, 100% of the amounts paid or incurred by the taxpayer to another person for clinical testing are eligible for the orphan drug credit. In figuring the research credit under section 41, do not include expenses subject to an election under section 28. However, you may

include expenses subject to an election under section 28 that are qualified research expenses (within the meaning of section 41(b)) to figure the base amount under section 41(c).

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.

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.

If you cannot use the research credit because of tax liability limitations, carry it back 3 years, then forward 15 years. Use Form 3800.

There are no carryback or carryover provisions for the orphan drug credit. However, your minimum tax carryover is increased if your orphan drug credit is limited by the tentative minimum tax.

Specific Instructions

Part I—Current Year Orphan Drug Credit

Termination of credit.—The orphan drug credit expires for any amount paid or incurred after December 31, 1994. Fiscal year filers, include on line 1 only amounts paid or incurred by December 31, 1994.

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 rest 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 next to 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 each beneficiary's share of the portion allocated to beneficiaries.

S corporations and partnerships.—

Allocate 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—Tax Liability
Limitation for the Orphan
Drug and Research Credits**

Line 5c.—Form 990-T filers, enter the total of either lines 35c and 37 or lines 36 and 37, whichever applies.

Line 8.—Enter the tentative minimum tax (TMT) that was figured on the appropriate alternative minimum tax (AMT) form or schedule. Although you may not owe AMT, you still must compute the TMT to figure your credit.

Line 10.—Include the orphan drug credit on the appropriate line of your 1994 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**

Termination of credit.—The research credit expires for any amount paid or incurred after June 30, 1995. Fiscal year filers, include on line 11 and lines 14 through 17 only those amounts paid or incurred by June 30, 1995.

Line 11.—Corporations (other than S corporations, personal holding companies, and service organizations) may be eligible for a "basic research" credit if their 1994 payments in cash to a qualified university or scientific research organization (under a written contract) exceed a base period amount (based on their general university giving and certain other maintenance-of-effort levels for the 3 preceding years). Enter your 1994 payments on line 11. See section 41(e) for details.

Line 12.—Enter the qualified organization 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 1994 basic research credit, can be treated as 1994 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 that does not exceed the line 12 base amount. See section 41(e)(1)(B).

Line 19.—The fixed-base percentage depends on whether you are an existing company or a start-up company. An existing company has both gross receipts and qualified research expenses for at least 3 tax years beginning after 1983 and before 1989 (the period). The fixed-base percentage for existing companies is the ratio that the aggregate qualified research expenses for the period bears to the aggregate gross receipts for the period. Round off the percentage to the nearest 1/100th of 1% (i.e., four decimal places). The maximum percentage allowed is 16%.

Start-up companies are those companies that have fewer than 3 tax years beginning after 1983 and before 1989 in which they had **both** gross receipts and qualified research expenses. The fixed-base percentage for start-up companies is 3% for the first 5 tax years beginning after 1993. 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).

Line 20.—Enter 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 lines 19 and 20, reduce gross receipts for any tax year by returns and allowances made during the tax year. For a foreign corporation, include only gross receipts that are effectively connected with the trade or business within the United States.

Line 21.—If you are a fiscal year filer with a tax year that ends after June 30, 1995, multiply line 20 by the percentage on line 19. Then, multiply that result by a fraction, the numerator of which is the number of days in the tax year before July 1, 1995, and the denominator is the total number of days in the tax year.

Line 23.—The base amount cannot be less than 50% of the current year qualified research expenses. This rule applies to existing and start-up companies.

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 schedule 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.—Allocate the research credit on line 28 between the estate or trust and the beneficiaries in the same proportion as income was allocated. In the margin for 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, if required) to figure the credit to take on Form 1041. On Schedule K-1, show each beneficiary's share of the portion allocated to beneficiaries.

S corporations and partnerships.—Allocate 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—Tax Liability
Limitation for the Research
Credit**

Note: If you have a current year research credit but do not have a current year orphan drug credit, complete lines 5 through 8 of Part II before completing Part IV.

Line 31.—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.—If you are an individual, estate, or trust, the credit(s) on line 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 the credit separately for each business enterprise by using the following formula:

$$(Line\ 30 - Line\ 31) \times \frac{\text{Taxable income attributable to your interest in the unincorporated business, 1065, 1041, or 1120S entity}}{\text{Taxable income for the year (Form 1040, line 37, or Form 1041, line 22)}}$$

The credit is limited to 100% of line 30 minus 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.