



Instructions for Form 6765

Credit for Increasing Research Activities

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

Paperwork Reduction Act Notice

We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping 8 hr., 22 min.

Learning about the law or the form 1 hr.

Preparing and sending the form to the IRS 1 hr., 10 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler we would be happy to hear from you. You can write to the IRS at the address listed in the instructions of the tax return with which this form is filed.

Items To Note

- The orphan drug credit expired December 31, 1994. However, a taxpayer that received an orphan drug credit from a partnership, S corporation, or trust with a fiscal tax year that began in 1994 and ended with or in the taxpayer's 1995 tax year should complete Part III to claim the credit.
- The research credit expired June 30, 1995. Include only those payments and expenses paid or incurred by the expiration date.
- 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 11.

General Instructions

Purpose of Form

Use Form 6765 to figure and claim the credit for increasing research activities and the orphan drug credit from 1994–95 flow-through entities.

Who Must File

An individual, estate, trust, organization, or corporation claiming a credit for increasing research activities or a flow-through orphan drug credit; or any S corporation, partnership, estate, or trust that allocates the credit 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 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).

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.

Specific Instructions

Part I—Current Year Credit for Increasing Research Activities

Termination of credit.—The research credit expired for any amount paid or incurred after June 30, 1995. Include on line 1 and lines 4 through 7 only those amounts paid or incurred by June 30, 1995.

Line 1.—Corporations (other than S corporations, personal holding companies, and service organizations) may be eligible for a “basic research” credit if their 1995 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 1995 payments on line 1. See section 41(e) for details.

Line 2.—Enter the qualified organization base period amount as defined in section 41(e). The amount on line 2 (but not more than the amount on line 1), although not eligible for the 1995 basic research credit, can be treated as 1995 contract research expenses on line 7 subject to the 65% limitation.

Line 6.—Enter the amount you paid or incurred for the rental or lease of computers used in qualified research. Reduce this amount by the amount that

you (or any member of a controlled group of corporations or businesses under common control) received or accrued for the right to use substantially identical property.

Line 7.—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 1 basic research payments that does not exceed the line 2 base amount.

Line 9.—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. 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). The fixed-base percentage for start-up companies is 3% for the first 5 tax years beginning after 1993.

Note: For lines 9 and 10, 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 10.—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.

Line 11.—Filers with a tax year that ends after June 30, 1995, multiply line 10 by the percentage on line 9. 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. For calendar year 1995 filers, this fraction is $\frac{181}{365} = .4959$.

Line 13.—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 16.—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 16. If the line 16 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 17.—Enter the amount of credit that was allocated to you as a shareholder, partner, or beneficiary.

Line 18—Estates and trusts.—Allocate the research credit on line 18 between the estate or trust and the beneficiaries in the same proportion as income was allocated. In the margin for line 18, the estate or trust should enter its share of the credit. Label it “1041 PORTION” and use this amount in Part II (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 that beneficiary.

S corporations and partnerships.—Allocate the research credit on line 18 among the shareholders or partners. Attach Form 6765 to the Form 1120S or 1065 and on Schedule K-1 show the credit for each shareholder or partner.

Who Must File Form 3800

The research credit shown on line 18 is one of the credits that make up the general business credit.

If for this year you have more than one of the credits included in the general business credit (see list on this page), have a carryback or carryforward of any of the credits, or have a research credit from a passive activity, you must complete **Form 3800**, General Business Credit, instead of Part II of Form 6765 to figure the tax liability limit for the credit.

The general business credit consists of the following credits:

- Investment (Form 3468),
- Jobs (Form 5884),
- Alcohol used as fuel (Form 6478),
- Research (Form 6765),
- Low-income housing (Form 8586),
- Enhanced oil recovery (Form 8830),
- Disabled access (Form 8826),
- Renewable electricity production (Form 8835),
- Indian employment (Form 8845),
- Employer social security and Medicare taxes paid on certain employee tips (Form 8846),

- Contributions to selected community development corporations (Form 8847), and
- Trans-Alaska pipeline liability fund.

The empowerment zone employment credit (Form 8844), while a component of the general business credit, is figured separately and is never carried to Form 3800.

Part II—Tax Liability Limit

Line 22.—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 24.—See section 38(c)(3) for special rules for married couples filing separate returns, for controlled corporate groups, and for estates and trusts.

Line 27.—If you are an individual, estate, or trust, the credit(s) on line 16 or 17 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:

$$\text{(Line 23 - Line 24)} \times \frac{\text{Taxable income attributable to your interest in the unincorporated business, 1065, 1041, or 1120S entity}}{\text{Taxable income for the year (Form 1040, line 37, or Form 1041, line 22)}}$$

The credit is limited to 100% of line 23 minus line 24.

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.

Part III—Current Year Orphan Drug Credit and Tax Liability Limit

Line 28.—Enter the orphan drug credit that was allocated to you as a partner, shareholder, or beneficiary from a flow-through entity whose fiscal year started in 1994 and ended with or in your 1995 tax year. If you have a credit from a passive activity, see **Form 8582-CR**, Passive Activity Credit Limitation, or **Form 8810**, Corporate Passive Activity Loss and Credit Limitations, before completing the rest of this form.

Line 34.—Enter this amount on your income tax return by including it in the “other credits” or “total credits” line, and write “ORPHAN DRUG CREDIT” and the amount on the dotted line to the left of the entry space.

