

# Instructions for Form 6765

## Credit for Increasing Research Activities

Section references are to the Internal Revenue Code.

### General Instructions

#### Changes To Note

The Tax and Trade Relief Extension Act of 1998 made the following changes that affect the research credit:

- Generally, the credit is now available for amounts paid or incurred before July 1, 1999.
- If the alternative incremental credit was elected for the first tax year beginning after June 30, 1996, and before July 1, 1997, the alternative credit will apply to amounts paid or incurred during the 36-month period beginning with the first month of that year. However, the 36-month period is reduced by the number of months after June 1996 that the taxpayer paid or incurred costs taken into account in figuring the regular credit.

If you filed a 1997–98 fiscal year return for a tax year that ended after June 30, 1998, you may need to file an amended return for that year to take into account costs paid or incurred after the credit expired under prior law but that now qualify for the credit.

#### Purpose of Form

Use Form 6765 to figure and claim the credit for increasing research activities (research credit).

#### Who Must File

An individual, estate, trust, organization, or corporation claiming a credit for increasing research activities; or any S corporation, partnership, estate, or trust that allocates the credit to its shareholders, partners, or beneficiaries must complete this form and attach it to its income tax return.

#### Qualified Research

The research credit is generally allowed for qualified research. **Qualified research** means research for which expenditures may be treated as section 174 expenses. 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, substantially all of the activities of the research must be elements of a process of experimentation relating to a new or improved function, performance, 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 **Form 8820**, Orphan Drug Credit.

See section 41 for other definitions and special rules.

#### 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 the tax liability limit, carry it back 1 year, then forward 20 years. Use Form 3800.

### Specific Instructions

#### Part I—Current Year Credit

You may claim the regular credit (Section A) or elect the alternative incremental credit (Section B). Under the alternative incremental credit, a smaller three-tiered fixed-base percentage and reduced three-tiered credit rate apply. You may want to figure your credit both ways to see which gives you the larger credit. However, once elected, the alternative incremental credit applies to the current tax year and all later tax years, unless you receive IRS consent to revoke the election.

#### Section A—Regular Credit

Include on lines 1 and 4 through 7 **ONLY** costs paid or incurred before July 1, 1999. Skip this section and go to Section B if you are electing or had previously elected the alternative incremental credit.

**Line 1.** Corporations (other than S corporations, personal holding companies, and service organizations) may be eligible for a “basic research” credit if 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 payments on this line. 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 (not to exceed the amount on line 1), although not eligible for the basic research credit, can be treated as contract research expenses on line 7 subject to the 65% (or 75%) 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.

However, use 75% in place of 65% for payments made to a qualified research consortium. A qualified research consortium is a tax-exempt organization described in section 501(c)(3) or 501(c)(6) that is organized and operated primarily to conduct scientific research and is not a private foundation.

**Line 9.** The fixed-base percentage depends on whether you are an existing company or a start-up company.

A start-up company is one that had **both** gross receipts and qualified research expenses either:

1. For the first time in a tax year beginning after 1983, or
2. For fewer than 3 tax years beginning after 1983 and before 1989.

The fixed-base percentage for a start-up company is 3%.

The fixed-based percentage for an existing company (any company that is not a start-up company) is figured by dividing the aggregate qualified research expenses for the tax years beginning after 1983 and before 1989 by the aggregate gross receipts for those tax years. Round off the percentage to the nearest 1/100th of 1% (i.e., four decimal places). The percentage cannot exceed 16%.

If gross receipts or qualified expenses are de minimis in a tax year or short tax years are involved, see sections 41(c)(3) and 41(f)(4).

**Note:** Reduce gross receipts by returns and allowances. For a foreign corporation, include only gross receipts that are effectively connected with a trade or business in the United States.

**Line 10.** Enter the average annual gross receipts (reduced by returns and allowances) for the 4 tax years preceding the tax year for which the credit is being determined. You may be required to annualize gross receipts for any short tax year. For a foreign corporation, include only gross receipts that are effectively connected with a trade or business in the United States.

**Line 11.** Multiply line 10 by the percentage on line 9. If your tax year ended before July 1, 1999, enter the result on line 11. If your tax year ended after June 30, 1999, multiply the result by a fraction, the numerator of which is the number of days in the tax year before July 1, 1999, and the denominator of which is the total number of days in the tax year. Enter that result on line 11.

**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 this line. If the 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.

## Section B—Alternative Incremental Credit

Complete this section **ONLY** if you are electing or had previously elected the alternative incremental credit instead of the regular credit.

The **period** for which you may include costs on lines 17 and 21 through 24 is limited as explained below:

- If the alternative incremental credit election **does not** apply to your first tax year that began after June 30, 1996, and before July 1, 1997, include on lines 17 and 21 through 24 **only** costs paid or incurred **before** July 1, 1999.

- If the alternative incremental credit election **applies** to your first tax year that began after June 30, 1996, and before July 1, 1997, include on lines 17 and 21 through 24 **only** costs paid or incurred during the tax year and also during the 36-month period that began with the first month of your first tax year that began after June 30, 1996, and before July 1, 1997. However, you must reduce the 36-month period by the number of full months after June 1996, and before the first tax year that began after June 30, 1996, during which any costs were paid or incurred that were used to figure the research credit.

**Example.** You first elected the alternative incremental credit for the tax year that began on September 1, 1996, and ended on August 31, 1997. You had previously paid or incurred costs used to figure the regular research credit after June 1996 and before September 1996 during August 1996. The period covered by the alternative incremental credit is limited to the 35-month period September 1996 through July 1999 (the 36-month period that began on September 1, 1996, reduced by the 1-month period (August 1996) during which you paid or incurred costs used to figure the regular research credit). Therefore, you may claim the credit for the tax year that began on September 1, 1998, only for costs incurred during the 11-month period from September 1998 through July 1999 (the 35-month period is reduced by the 24-month period used to figure the alternative incremental credit in the 2 prior tax years).

**Line 18.** Enter the qualified organization base period amount as defined in section 41(e). The amount on line 18 (not to exceed the amount on line 17), although not eligible for the basic research credit, can be treated as contract research expenses on line 24 subject to the 65% (or 75%) limitation.

**Line 40.** Enter the amount of credit that was allocated to you as a shareholder, partner, or beneficiary.

### Line 41—

**Estates and trusts.** Allocate the research credit on line 41 between the estate or trust and the beneficiaries in the same proportion as income was allocated. In the margin for line 41, 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 41 among the shareholders or partners. Attach Form 6765 to Form 1120S or 1065 and on Schedule K-1 show the credit for each shareholder or partner. Electing large partnerships, include this credit in "general credits."

## Who Must File Form 3800

Complete **Form 3800**, General Business Credit, instead of Part II of Form 6765, to

figure the tax liability limit for the credit if for this year you have:

- More than one of the credits included in the general business credit (see list below),
- A carryback or carryforward of any of the credits,
- A research credit from a passive activity, or
- General credits from an electing large partnership (Schedule K-1 (Form 1065-B)).

The general business credit consists of the following credits:

- Investment (Form 3468),
- Work opportunity (Form 5884),
- Welfare-to-work (Form 8861),
- 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),
- Orphan drug (Form 8820),
- 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 47.** Although you may not owe alternative minimum tax (AMT), you generally must still compute the tentative minimum tax (TMT) to figure your credit. For a small corporation exempt from the AMT under section 55(e), enter zero. Otherwise, enter the TMT that was figured on the appropriate AMT form or schedule.

**Line 48.** See section 38(c)(3) for special rules that apply to married couples filing separate returns, controlled corporate groups, regulated investment companies, real estate investment trusts, and estates and trusts.

**Line 51.** For an individual, estate, or trust, the credit(s) on line 16, 39, or 40 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:

$$\text{(Line 46 - Line 48)} \times \frac{\text{Taxable income attributable to your interest in the sole proprietorship or flow-through entity}}{\text{Taxable income for the year (Form 1040, line 39, or Form 1041, line 22)}}$$

The credit is limited to 100% of line 46 minus line 48.

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.