

1996



Department of the Treasury
Internal Revenue Service

Instructions for Form 6765

Credit for Increasing Research Activities

Section references are to the Internal Revenue Code.

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.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 15 hr., 19 min.; **Learning about the law or the form**, 1 hr., 29 min.; **Preparing and sending the form to the IRS**, 1 hr., 49 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 for the tax return with which this form is filed.

Changes To Note

- The research credit and the orphan drug credit have been reinstated, effective for costs paid or incurred after June 30, 1996, and before June 1, 1997 (with a special rule for taxpayers who elect a new alternative incremental research credit). New **Form 8820**, Orphan Drug Credit, is used to report the orphan drug credit, which is now part of the general business credit.
- Instead of the regular credit, taxpayers may elect a new alternative incremental credit for costs paid or incurred during the first 11 months of the taxpayer's first tax year beginning after June 30, 1996. Under the alternative incremental credit, taxpayers are assigned a smaller three-tiered fixed-base percentage and a reduced three-tiered credit rate.
- The definition of start-up companies (those eligible for a fixed-base percentage of 3%) has been expanded to include taxpayers that had both gross receipts and qualified research expenses for the first time in a tax year beginning after 1983.

- Effective for tax years beginning after June 30, 1996, 75% (instead of 65%) of payments made to certain nonprofit qualified research consortia are treated as qualified research expenses.

General Instructions

Purpose of Form

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

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.

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 tax liability limitations, carry it back 3 years, then forward 15 years. Use Form 3800.

Specific Instructions

Part I—Current Year Credit

Section A—Regular Credit

Include on line 1 and lines 4 through 7 **ONLY** costs paid or incurred after June 30, 1996, and before June 1, 1997. Skip this section and go to Section B if you are electing 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, for tax years beginning after June 30, 1996, 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. Then, multiply that result by a fraction, the numerator of which is the number of days in the tax year after June 30, 1996, and before June 1, 1997, and the denominator of which is the total number of days in the tax year.

For calendar year 1996 filers, this fraction is $\frac{184}{366} = .5027$.

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 your tax year began after June 30, 1996, and you are electing the alternative incremental credit instead of the regular credit. To be valid, the election must be made for the first tax year beginning after June 30, 1996. Once made, the election applies to the current tax year and all later tax years, unless you receive IRS consent to revoke the election. Include on line 17 and lines 21 through 24 **ONLY** costs paid or incurred during the first 11 months of the tax year.

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.

Who Must File Form 3800

The research credit shown on line 41 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 below), 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),
- Work opportunity (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),
- 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.— 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 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:

	Taxable income attributable to your interest in the sole proprietorship or flow-through entity
(Line 46 – Line 48) ×	$\frac{\text{Taxable income for the year (Form 1040, line 37, or Form 1041, line 22)}}{\text{Taxable income for the year (Form 1040, line 37, or Form 1041, line 22)}}$

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.