

## **2014 Instructions for Schedule RC**

### **Research Credit**

#### **What Is the Research Credit?**

The Research Credit is a tax credit available to corporations who incur certain expenses for research conducted in Massachusetts. The credit closely parallels the federal research credit available under sec. 41 of the Internal Revenue Code (IRC) as of August 12, 1991. For further information, see Regulation 830 CMR 63.38M.1.

#### **Who Is Eligible for the Credit?**

Any business corporation subject to the Massachusetts corporate excise under Chapter 63 of the Massachusetts General Laws (M.G.L.) is eligible for the credit. An S corporation may apply the research credit against its excise due under Chapter 63, but may not share any excess credit with its shareholders.

#### **How Is the Research Credit Determined?**

Generally, the Massachusetts research credit adopts the definitions and calculations for the federal research credit under sec. 41 of the Internal Revenue Code (IRC) as in effect on August 12, 1991. There is an additional requirement that the expenditures must be for research conducted within Massachusetts.

The amount of the credit equals 15% of the incremental basic research payments, plus 10% of the incremental qualified research expenses. Both basic research payments and qualified research expenses are defined under IRC, sec. 41. Incremental expenses and payments are those which exceed certain base amounts.

#### **Effect of Election to Use Massachusetts Gross Receipts**

The base amount for the determination of incremental qualified research expenses is the largest of 50% of the qualified research expenses or the product of the Massachusetts fixed-base percentage and the corporation's average annual gross receipts for the last four years.

Taxpayers may elect to calculate the base amount considering only Massachusetts receipts.

Taxpayers electing to compute average annual gross receipts in this computation must also use only Massachusetts receipts in calculating the Massachusetts fixed base percentage.

Corporations elect to use either Massachusetts or federal gross receipts in determining the base amount in the first year in which they claim the credit. An election is binding for the three consecutive tax years beginning in the year the choice is first made. Thereafter the corporation may alter its choice prospectively in any subsequent taxable year, provided that any change shall also be binding for the three year period commencing with the year of the change. An election may not be changed by filing an amended return or claim for abatement. See Regulation 830 CMR 63.38M.1 (5) (d) 3.

### **Aggregated Groups**

Any corporation which is a member of a controlled group or which is under common control with any trade or business (whether or not incorporated) must calculate its credit on an aggregated basis. The entire group first calculates a total credit as if it was a single taxpayer, aggregating all qualified research expenses and basic research payments made by the members, eliminating inter-company payments. The members of the group are then allocated a share of this credit based on their share of the group's total qualified research expenses and qualified research payments. See Regulation 830 CMR 63.38M.1 (7).

### **Separate Calculation for Defense-Related Activities and Other Qualified Activities**

Under legislation approved in November of 1995, eligible corporations may, for taxable years beginning on and after January 1, 1995, calculate the research credit separately for their defense-related and their non-defense-related activities.

In general, defense-related activities include those activities occurring in Massachusetts in connection with researching, developing and producing for sale equipment for NASA or certain military arms, pursuant to a contract or subcontract. For purposes of calculating the credit, military arms are arms, ammunition, or implements of war specifically designed, modified, or equipped for military purposes and designated in the munitions list published pursuant to 22 U.S.C. 2778. Corporations making this election must also maintain complete records of supporting data including the accounting methods used in calculating the credit.

### **Life Sciences Research Credit**

For taxable years beginning on or after January 1, 2009, M. G.L. Ch. 63, sec 38W adds a new Life Sciences Research Credit, to the extent authorized for certified life sciences companies pursuant to the Life Sciences Tax Incentive Program, to provide qualifying companies with a means to obtain a research credit for certain expenditures not qualifying for the existing research credit under M.G.L. Ch. 63, sec. 38M.

Under this new provision, the credit is generally calculated in the same manner as the research credit under sec. 38M. However, the qualified research expenditures, which form the basis for the calculation in new sec. 38W, differ from those of sec. 38M in that they can qualify when the activities are performed both inside and outside of the Commonwealth, to the extent they relate to legally mandated clinical trial activities.

### **Limitations on Applying the Credit Against Excise**

The credit is limited to the first \$25,000 of excise plus 75% of any excise in excess of \$25,000. In addition, the credit cannot reduce the tax below the minimum tax of \$456.

Corporations which are members of an aggregated group share a single \$25,000 of excise which is not subject to the 75% limitation. Each corporation is allowed a share of this bracket determined by the ratio of the corporation's separately determined excise to the total for all members of the aggregated group. No member of the group may reduce its excise below the minimum tax of \$456. Corporations which file a combined under M.G.L. Chapter 63, sec. 32B may share excess credits with other corporations included in the same combined return to the extent the other corporations can use additional research credits within the limitations as determined above. See 830 CMR 63.32B.2 (9) (a) and (c) for rules applicable to the sharing of credits.

### **Are Research Credit Carryovers Allowed?**

Yes. The research credit cannot reduce the corporation's excise below the minimum excise and cannot reduce the excise over \$25,000 by more than 75%. Credits which exceed these limitations can be carried over to future tax years and applied against the corporate excise.

There are two types of carryovers:

#### **Unlimited Carryover**

A corporation may carry over for an unlimited period of time any portion of the credit which is disallowed under the 75% limitation. Credits disallowed under the 75% limitation equal 25% of the corporation's excise which exceeds \$25,000

#### **15-Year Carryover**

Any credits disallowed which are not given unlimited status, may be carried forward for fifteen years.

#### **Record Keeping Requirements**

Corporations claiming the Research Credit must maintain adequate records to substantiate the calculation of the credit. See Regulation 830 CMR 63.38M.1 (14), as amended October 2, 1998.

#### **Schedule RC Line Information**

##### **Part 1. Massachusetts Research Credit Generated**

Each corporation which generates or uses Massachusetts Research Credit must complete Schedule RC as part of their separate return.

Each corporation must check the appropriate box to indicate whether Massachusetts or federal gross receipts are being used for the calculations.

Only corporations electing to calculate credits separately for defense and non-defense activities or corporations claiming the Life Sciences Research Credit under sec. 38W should complete the second question.

Corporations calculating the 38M credit separately for defense related activities complete Part 1 separately for defense and non-defense activities but combine the credits generated from the two schedules when completing Part 2 and Part 3.

Corporations claiming the Life Sciences Research Credit under sec. 38W that also have credits due under sec. 38M, either from the current year or carried over from a prior year, must separately use or carry forward the credits by completing separate Part 2 and Part 3 pages for credits generated under 38M and credits generated under 38W.

##### **Line 1**

Enter the amount of basic research payments which relate to basic research activity conducted in Massachusetts. These expenses must qualify under section 41(e) (2) of the IRC.

**Line 2**

Corporations which are members of a group which must compute the credit on an aggregate basis, enter the total Massachusetts basic research payments made by all members of the group on line 2. Corporations which are not members of an aggregated group should enter the amount shown in line 1 in line 2.

**Line 3**

Enter the base period amount, as defined under section 41(e) of the IRC, which includes only expenses attributable to research activity conducted in Massachusetts and payments made to organizations organized under the laws of Massachusetts.

**Line 4**

Subtract line 3 from line 2 and enter the difference here. This amount is the incremental basic research payments which qualify for the credit.

**Line 5**

Multiply line 4 by 15% (.15) and enter the result here. This amount equals the credit for basic research payments before any limitations.

**Massachusetts Qualified Research Expenses****Line 6**

Enter the amount of wages paid for qualified services, as defined by section 41(b) (2) (B) of the IRC, performed in Massachusetts.

**Line 7**

Enter the amount paid for supplies, as defined by section 41(b) (2) (C) of the IRC, used or consumed in Massachusetts in conducting qualified research.

**Line 8**

Enter the amounts paid for the right to use computers located in Massachusetts in the conduct of qualified research that takes place in Massachusetts, to the extent such amounts are treated as in-house research expenses under section 41(b)(2)(A)(iii) of the IRC.

**Line 9**

Enter 65% of amounts paid to others as contract research expenses, as defined by section 41(b)(3) of the IRC, to the extent attributable to research activity conducted at a research facility located in Massachusetts. Also include 65% of that portion of the line 1 basic research payments which does not exceed the line 3 base amount, as allowed under section 41(e) (1) (B) of the IRC.

**Line 10**

Add lines 6 through 9. This amount equals your total qualified research expenses.

**Line 11**

Corporations which are members of a group which must compute the credit on an aggregate basis must enter the total Massachusetts qualified research expenses made by all members of the group in line 11. Corporations which are not members of an aggregated group should enter the same amount shown in line 10 in line 11.

**Line 12**

The Massachusetts fixed-base percentage is determined by dividing the corporation's aggregate Massachusetts qualified research expenses for all taxable years beginning after December 31, 1983 and before January 1, 1989 by the corporation's aggregate gross receipts for such taxable years. If the corporation is calculating the credit using Massachusetts gross receipts, both the fixed base percentage and the average annual receipts figure on line 13 must be calculated using Massachusetts gross receipts.

The fixed base percentage should be rounded to the nearest 1/100 of 1% and cannot exceed 16%. The Massachusetts fixed-base percentage for start-up companies is 3%. See Regulation 830 CMR 63.38M.1 (5) (c) 2, for the definition of start-up companies. If a corporation cannot compute the Massachusetts fixed-base percentage due to inadequate records for the base period, the Massachusetts fixed base percentage is 16%.

Corporations which are members of a group which must compute the credit on an aggregate basis must calculate and enter in line 12 a fixed-base percentage for the group as a whole. See Regulation 830 CMR 63.38M.1 (7)

Special rules also apply to the calculation of both the fixed base percentage in line 12 and the average annual receipts in line 13 with respect to mergers and acquisitions. See Regulation 830 CMR 63.38M.1 (11).

**Line 13**

Enter the corporation's average annual gross receipts (Massachusetts gross receipts, if that election has been made) for the four taxable years preceding the taxable year for which the credit is being determined. Corporations which are members of a group which must compute the credit on an aggregate basis, enter the total receipts for the group.

**Line 14**

Multiply line 13 by the percentage in line 12. Enter the greater of this amount or 50% of the qualified research expenses in line 11. The base amount cannot be less than 50% of the current year qualified research expenses.

**Line 15**

Subtract line 14 from line 10. This amount equals the incremental qualified research expenses which qualify for the credit.

**Line 16**

Multiply line 15 by 10% (.10). This amount equals the credit for qualified research expenses before any limitations.

**Line 21**

Corporations which are part of an aggregated group will compute the group credit based on the activities and base amounts for the group as a whole (the total of the amounts on line 5 and line 16) and then determine the portion of that credit allocated to each corporation based on its share of basic research payments and qualified expenses.

Corporations which are not part of an aggregated group will have a 100% allocation percentage on line 19 and line 21 will equal the total of lines 5 and 16.

Corporations are required to reduce their deduction for research expenses by the amount of the credit generated. Corporations which report their income on Form 355 or 355S make this adjustment on Schedule E, line 13. Corporations reporting their income on Form 355U make this adjustment on Schedule U-E, line 20.

**Part 2. Massachusetts Research Credit Used****Line 1**

Excise before credit. Corporations not participating in a combined return enter the amount from Form 355, line 5 or Form 355S, line 8. Corporations filing Form 355U enter the total excise for the year, including both the income and non-income measures. This amount is calculated on Schedule U-IC, line 1.

**Line 2**

Corporations which are members of a group which must compute the credit on an aggregate basis must enter the total of the excise before credit amounts of all members of group. Corporations which are not members of a group, enter the amount shown in line 1 in line 2.

**Line 4**

If the corporation is not a member of an aggregate group, or if the total excise for the group shown in line 2 is less than or equal to \$25,000, enter the amount from Part 2, line 1 here. Otherwise, multiply the amount on line 1 by the allocation percentage in line 3. **Do not enter an amount in line 4 that is greater than the amount in line 1.**

**Line 7**

The credit a corporation may take against excise in a given year is limited to the first \$25,000 of excise (or the corporation's share of that amount if it is part of a group) plus 75% of any excise in excess of \$25,000. Enter that amount in line 7.

**Line 8**

If a corporation qualifies for several credits, which combined with the allowable research credit would reduce the corporate excise below the minimum tax; a choice must be made as to which credits will be utilized because of the minimum tax limitation.

For example, XYZ Co. with \$1,000 of corporate excise, \$500 of vanpool credits and \$1,000 of research credits could apply \$500 of vanpool credits to the corporate excise. XYZ Co. would then be able to use only \$44 of the research credit because the excise (after applying the vanpool credit) is already reduced to \$500. In this scenario, XYZ would be able to carry forward the unused research credits. Alternately, XYZ could have chosen to use \$544 of research credit and no vanpool credit, but the vanpool credits would have expired. If the corporation is taking other credits against its excise this year, enter the total of those credits in line 8.

**Line 9**

The research credit may not reduce the excise below the \$456 minimum tax that applies to all business corporations. Enter the smaller of the amount from Part 2, line 1 minus the amount on Part 2, line 8 minus \$456 or the amount in Part 2, line 7.

**Line 14**

Enter the smaller of Part 2, line 9 (the maximum amount of research credit the corporation may use in the current tax year) and Part 2, line 13 (the amount of the corporation's own research credit available for use).

**Line 15**

If the corporation is filing a Massachusetts combined return and has excess credits (Part 2, line 13 is greater than Part 2, line 14) it may allow other members of the group to use those credits. Enter the total amount of this corporation's credit used by all other group members this year.

**Part 3. Reconciliation of Research Credit Carryover**

Research credits are earned by and carried forward by individual corporations. In the event of a merger, credits generated by a corporation absorbed in the merger are lost. Each corporation must track its credits carried forward separately.

To determine the amount of credits that may potentially expire, taxpayers must track credits still subject to the 15-year time limit by the taxable year in which they were generated. Taxpayers must designate (by taxable year) which credits are being used in Part 3.

Credits used by a corporation against its own excise may use any available credits; normally these should be subtracted first from the oldest time-limited credits available. Credits of one corporation that are used by another corporation under the sharing rules may only be credits for which the requirements of 830 CMR 63.32B.2 (9) are met. The total of this corporation's credits used from each prior year, whether the credits are used by this corporation or by its affiliates, is entered in column (b). The total of the amounts in column (b) for lines 1-17 must equal the total on line 19. A corporation that is a certified life sciences company may be authorized pursuant to the life sciences tax incentive program to receive a refund of 90% of the amount of unused credit available under sec 38M (but not for credits under 38W). Any such refund must be specifically authorized by the Massachusetts Life Sciences Center. See TIR 08-23 for further information. The total of credits for which such a refund is being sought (before the reduction to 90% as required by sec 38M (j)) is entered on line 21.

If the corporation, after accounting for credits used against its own excise, credits shared with affiliates and credits for which a refund is being requested as described above, has excess credits available for carryover, some of those credits that are still subject to the 15-year time limit may be converted to unlimited carryover status. The amount of credit eligible for conversion is the lesser of the amount of unused credit still subject to the 15-year time limit and the amount disallowed by the limitation on use in sec. 38M (d) (Part 2, line 1 minus Part 2, line 7). The amount converted is entered on line 22.

Taxpayers must designate by taxable year which credits are to be refunded or converted in column (c). These credits should normally be subtracted from the oldest time-limited credits first. If any credit still subject to the 15-year time limit is not used, refunded or converted by

the end of the current taxable year, it expires and the amount of any expiring credit must be added to the amount refunded or converted in completing 1(c). Enter the amount of credits that expire on line 23. The total of the amounts on line 21, 22 & 23 must equal the total of the amounts in column (c) for lines 1-17.

Lines 24 and 25 are a reconciliation of total credits available for carryover. Line 24 includes all credits carried forward to the subsequent year and equals line 20 (total credits not used) less the any amount on line 21 (adjustment for authorized certified life sciences company refunds) and any amount on line 23 (credits expired). Line 25 includes only those credits (part of the total carryover shown on line 24) which are no longer subject to the 15-year time limit and equals the amount on 17(a) less the amounts used or refunded as shown on 17(b) and 17 (c) plus any amount converted this year as shown on line 22.