

## **2015 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.

Effective for tax years beginning on or after January 1, 2015, St. 2014, c. 287 changed the method for calculating the amount of credit allowable with respect to the taxpayer's qualified research expenses. For further information, see TIR 14-13 and TIR 14-16 and Regulation 830 CMR 63.38M.2.

#### **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.

Changes in effect for taxable years beginning on or after January 1, 2015 affect the calculation of the credit for incremental qualified research expenses. Taxpayers now have 2 options, the first of which is similar to the method in effect in 2014 and prior years.

- The definition of "qualified research expense" is unchanged. Expenses are qualified research expenses for the Massachusetts Credit if they meet the definition of qualified research expense under IRC, sec 41 as in effect on August 12, 1991 and were for research conducted in Massachusetts.
- The "fixed base percentage" has been replaced with a "fixed base ratio." The fixed base ratio is determined by taking the total of the taxpayer's qualified research expenses for the 3<sup>rd</sup> and 4<sup>th</sup> prior taxable years and dividing that amount by the taxpayer's total gross receipts for the same two taxable years. The fixed base ratio may not exceed 16%. A taxpayer whose gross receipts for the 3<sup>rd</sup> and 4<sup>th</sup> taxable years preceding the credit year equal zero is not eligible to compute its credit using the method prescribed under G.L. c. 63, § 38M(a) and must calculate its credit using the alternative simplified method under G.L. c. 63, §38M(b).
- The "base amount" is now calculated using the new "fixed base ratio", which is multiplied by the average annual receipts for the four taxable years preceding the credit

year. The minimum base amount is 50% of the qualified research expenses for the current year.

- The credit allowed is still 10% of the amount by which a taxpayer's qualified research expenses exceed the base amount.

Beginning in 2015, Taxpayers may elect to calculate the credit for qualified research expenses using an alternative simplified method. In addition, taxpayers not eligible to calculate the credit under G.L. c. 63, § 38M(a) must calculate the credit using the alternative simplified method.

- The definition of “qualified research expense” is unchanged. Expenses are qualified research expenses for the Massachusetts Credit if they meet the definition of qualified research expense under IRC, sec 41 as in effect on August 12, 1991 and were for research conducted in Massachusetts.
- The “base amount” is 50% of the average of the taxpayer’s qualified research expenses for the most recent three taxable years.
- The credit for 2015 is 5% of the current year QREs over the base amount.
- If the corporation calculating the credit using the alternative simplified method did not have qualified research expenses in each of the three taxable years preceding the credit year, the credit allowed is 5% of the qualified research expenses for the current year.

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

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 ratio.

### **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.2. An aggregated group whose gross receipts for the 3<sup>rd</sup> and 4<sup>th</sup> taxable years preceding the credit year equal zero is not eligible to compute its credit using the method prescribed under G.L. c. 63, § 38M(a) and must calculate its credit using the alternative simplified method under G.L. c. 63, §38M(b).

### **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.

Taxpayers may not claim the credit under c. 63, s. 38W except as specifically authorized to do so by the Massachusetts Life Sciences Center.

Authorized taxpayers calculate the credit under this section in the same manner as was applicable in calculating the research credit under sec. 38M prior to 2015. The changes in the calculation of the regular research credit outlined above do not apply. 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 amount 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 report 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.2 (16)

### **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 electing to calculate the credit using the fixed base ratio must check the appropriate box to indicate whether Massachusetts or federal gross receipts are being used for the calculations. Corporations electing to calculate the credit using the alternative simplified credit method, leave this blank.

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.

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 pages for credits generated under 38M and credits generated under 38W.

### **Massachusetts Basic Research Payments**

**Corporations calculating the credit using the alternative simplified method leave Lines 1-5 blank.**

**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.

**Corporations computing the credit using the alternative simplified method leave lines 12&13 blank**

#### Line 12

The Massachusetts fixed-base ratio is determined by dividing the corporation's aggregate Massachusetts qualified research expenses for the 3<sup>rd</sup> & 4<sup>th</sup> prior taxable years 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 ratio and the average annual receipts figure on line 13 must be calculated using Massachusetts gross receipts.

A taxpayer whose gross receipts for the 3<sup>rd</sup> and 4<sup>th</sup> taxable years preceding the credit year equal zero is not eligible to compute its credit using the method prescribed under G.L. c. 63, §38M(a) and must calculate its credit using the alternative simplified method under G.L. c. 63, §38M(b). Leave line 12 blank.

The fixed base ratio should be rounded to the nearest 1/100 of 1% and cannot exceed 16%. If a corporation cannot compute the Massachusetts fixed-base ratio due to inadequate records for the base period, the Massachusetts fixed base ratio 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 ratio for the group as a whole. See Regulation 830 CMR 63.38M.2 (9).

An aggregated group whose gross receipts for the 3<sup>rd</sup> and 4<sup>th</sup> taxable years preceding the credit year equal zero is not eligible to compute its credit using the method prescribed under G.L. c. 63, §38M(a) and must calculate its credit using the alternative simplified method under G.L. c. 63, §38M(b). Leave line 12 blank.

Special rules also apply to the calculation of both the fixed base ratio in line 12 and the average annual receipts in line 13 with respect to mergers and acquisitions. See Regulation 830 CMR 63.38M.2 (13).

#### Line 13

Taxpayer's calculating the credit using the fixed base ratio, 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. Corporations calculating the credit using the alternative simplified method leave line 13 blank.

#### Line 14

Enter the appropriate base amount.

- Corporations calculating the credit using the fixed base ratio, Multiply line 13 by the ratio in line 12. Enter the larger of the calculated amount or 50% of the qualified research expenses shown on line 11.
- Corporations calculating the credit using the alternative simplified method enter 50% of the average of the qualified research expenses for the last 3 taxable years.

If the corporation calculating the credit using the alternative simplified method did not have qualified research expenses in each of the three taxable years preceding the credit year, leave line 14 blank. The credit allowed is 5% of the qualified research expenses for the current year.

### **Line 15**

Subtract line 14 from line 11. Do not enter less than zero. This amount equals the incremental qualified research expenses which qualify for the credit.

### **Line 16**

- Multiply line 15 by the applicable rate. For taxpayers calculating the credit using the fixed base ratio, multiply line 15 by 10% (.10). For taxpayers calculating the credit using the alternative simplified method, multiply line 15 by 5% (.05).

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.

Note: Enter the amount of the tentative credit shown on line 21 on the credit manager schedule.

## **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 member's total excise for the year, including both the income and non-income measures from this member's schedule U-ST, line 37.

**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.

**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.

**This is the maximum amount of research credit that may be taken if no other restrictions apply. A corporation may not take research credit to reduce its excise below the \$456 minimum excise specified in c. 63, s. 39(b).**