

2017 Schedule RC Instructions

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 section 41 of the Internal Revenue Code (IRC s. 41).

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 Proposed Regulation 830 CMR 63.38M.2.

Who Is Eligible for the Credit?

Any business corporation subject to the Massachusetts corporate excise under chapter 63, s. 39 of the Massachusetts General Laws (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 or the federal research credit under IRC s. 41. There is an additional requirement that the expenditures must be for research conducted within Massachusetts.

For taxable years beginning on or after January 1, 2015, taxpayers now have 2 options under G.L. c. 63, s. 38M to calculate the credit. The first option under G.L. c. 63, s. 38M(a) 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 s. 41 as in effect on August 12, 1991 and are 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 third and fourth taxable years preceding the credit year 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 third and fourth taxable years preceding the credit year equal 0 is not eligible to compute its credit using the method prescribed under G.L. c. 63, s. 38M(a) and must calculate its credit using the alternative simplified method under G.L. c. 63, s. 38M(b).

- The "base amount" is now calculated by multiplying the new "fixed-base ratio", by the average annual receipts from the 4 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 for the current year exceed the base amount.

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

- Expenses are qualified research expenses for the Massachusetts credit if they meet the definition of qualified research expenses under IRC s. 41 as in effect on January 1, 2014 and are for research conducted in Massachusetts.

- The "base amount" is 50% of the average of the taxpayer's qualified research expenses over the three taxable years preceding the credit year.

- The credit for 2017 is 5% of the current year qualified research expenses 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 use Massachusetts receipts must compute average annual gross receipts and the fixed-base ratio using only Massachusetts receipts..

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 Proposed Regulation 830 CMR 63.38M.2

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.

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 G.L. c. 63, s. 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 Regulation 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 Proposed Regulation 830 CMR 63.38M.2(16)

How Do I Claim the Life Science Research Credit?

Massachusetts has a separate credit for corporations under G.L. c. 63, s. 38W, which is available to taxpayers that have been certified as life science companies pursuant to the Life Sciences Tax Incentive Program and who have been specifically authorized to take the credit under s. 38W by the Massachusetts Life Sciences Center (the MLSC has a variety of credits available and not all life sciences companies will be authorized to take the credit under s. 38W.)

The Massachusetts Life Sciences Center will issue a unique certificate number to the taxpayer as part of the award process. That certificate number must be used to claim the credit under G.L. c. 63, s. 38W and the award may be limited by the MLSC as to the maximum amount, timing or other criteria.

The determination of the s. 38W credit is also modeled on the credit under IRC s. 41, basing many of its definitions in that section, but requires computation using a fixed base percentage determined under the IRC as of August 12, 1991. The calculations are similar to those used on schedule RC as published for years 2009-2014 which may be used as a guide. In no event may the amount of the s. 38W credit exceed the amount authorized by the Massachusetts Life Sciences Center.

Taxpayers seeking to claim the credit under s. 38W on their return will calculate the amount on a worksheet they will retain for their records and will report the credit due (but not more than the amount authorized by the Massachusetts Life Sciences Center) on the credit manager schedule filed with their return. When en-

tering this information, taxpayers must also enter the certificate number issued by the MLSC. For more information see TIR 08-23.

Schedule RC Line Information

Part 1. Massachusetts Research Credit Generated

Each corporation which generates or uses Massachusetts research credit under G.L. c. 63, s. 38M must complete Schedule RC as part of their return. Corporations claiming the Life Sciences Research Credit under G.L. c. 63, s. 38W do not file schedule RC.

Elections:

- Corporations may elect to calculate the research credit separately for defense-related activities. If making the election, the corporation will complete Part 1 separately for defense and non-defense activities and combine the amounts when completing the credit manager schedule. Check this box on schedule RC if the corporation is making this election and this schedule reports the research expenses and shows the credit calculations for the defense related activities. The corporation will file a second schedule, without checking this box, to report non-defense research activities.

- Corporation may elect to calculate the credit using the Alternative Simplified Method (G.L. c. 63, s. 38M (b)) by checking the 2nd box in the header. These corporations will complete lines 7 through 13, but will not complete lines 14 through 22.

- Corporations calculating the credit under G.L. c. 63, s. 38M (b) may elect to calculate both the fixed-base ratio and average annual receipts using only Massachusetts gross receipts. Check the third box if electing to use Massachusetts gross receipts. If this box is not checked, federal gross receipts are used for both the fixed base ratio and the average annual receipts.

If the taxpayer is required to calculate its research credit on an aggregated basis, all members of the group must make the same elections.

Massachusetts Qualified Research Expenses

Line 1

Enter the amount this corporation paid as wages for qualified services, as defined by IRC s. 41(b) (2) (B), to the extent those services were performed in Massachusetts.

Line 2

Enter the amount this corporation's expenses for supplies, as defined by IRC s. 41(b) (2) (C), used or consumed in Massachusetts in conducting qualified research.

Line 3

Enter the amounts by this corporation's expenses 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 IRC s. 41(b)(2)(A)(iii).

Line 4

Enter 65% of this corporation's expenses paid to others as contract research expenses, as defined by IRC s. 41(b)(3), 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 IRC s. 41(e) (1) (B).

Line 5

Add lines 1 through 4. This amount equals your total qualified research expenses.

Line 6

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 6. A Corporation which is not a member of an aggregated group should enter the same amount shown in line 5 in line 6.

Credit Calculated under c. 63, s. 38M(b) — Alternative Simplified Method

If the taxpayer is *not* calculating the credit under the Alternative Simplified Method, leave lines 7 through 13 blank.

Line 7

If the corporation is calculating the credit under the Alternative Simplified Method, enter the total of the Massachusetts qualified research expenses for the three most recent taxable years preceding the credit year provided the taxpayer had such qualified expenses in each of the three years.

- If the taxpayer is part of a group required to calculate the credit on an aggregated basis, enter the total expenses for the group.
- If the taxpayer using the Alternative Simplified Method did not have qualified research expenses for each of the three prior years, check the box and skip lines 7 through 10. On line 11 enter 5% of current year expenses on line 6 amount. .

Line 8

Enter 50% of the total qualified expenses as reported on line 7.

Line 9

Subtract the amount on line 8 from the amount on line 7. Enter "0" if line 8 is greater than line 7.

Line 10

Enter the applicable tax rate for the year. For years beginning on or after January 1, 2015 and before January 1, 2018, enter 5% as .050.

Line 11

The total credit for the group is either (a) 5% of the amount on line 6 if the taxpayer did not have qualified research expenses in each of the three prior years or (b) the amount determined by multiplying line 9 by line 10.

Line 12

The percentage of the credit on line 11 attributable to this corporation is the same as the ratio of the corporation's qualified expenses on line 5 to the group's expenses on line 6. Carry this figure to four decimal places. Corporations which are not part of an aggregated group for calculating the research credit will have a 100% allocation percentage.

Line 13

The credit attributable to this corporation is the amount on line 11 multiplied by the percentage on line 12. Enter the amount of credit shown here on the credit manager schedule.

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.

Credit Calculated under c. 63, s. 38M(a)

Corporations calculating the credit under the Alternative Simplified Method (above), leave lines 14 through 22 blank.

Line 14

Enter the fixed base ratio. This is the total of the corporation's Massachusetts qualified research expenses for the third and fourth prior taxable years divided by its receipts during those same years. If the corporation is required to calculate its credit on an aggregated basis, this amount should be computed using the qualified expenses and the aggregated receipts of the group. The fixed base ratio is figured to four decimal places and may not exceed 16% (.1600).

Line 15

Enter the average annual receipts for the four most recently completed taxable years. If the taxpayer has elected to calculate the fixed base ratio using Massachusetts gross receipts, the average annual receipts is also computed using only Massachusetts gross receipts.

Line 16

The base amount is the greater of 50% of the total qualified expenses reported on line 6 or line 14 multiplied by line 15.

Line 17

Subtract the amount on line 16 from the total qualified expense reported on line 6. If the result is less than 0, enter "0."

Line 18

The total credit for the group for its qualified research expenses is 10% of the incremental expenses (the amount on line 17).

Line 19

Corporation's calculating the credit under s. 38M(a) receive credit measured by their own qualified expenses and may also receive credit for basic research payments that qualify as such under IRC s. 41(e)(2). Basic research payments under the Code must be made subject to a written agreement between the corporation and a qualified organization (including educational institutions, certain scientific research organizations, scientific tax-exempt organizations and certain grant organizations). The credit allowed is equal to 15% of the excess of the current year basic research payments over the base amount as defined under IRC s. 41(e). Both the current year payments eligible for credit and the base amount are calculated considering only payments for research done in Massachusetts.

If the corporation (aggregated group) made basic research payments that qualify under the IRC and exceed the base amount, enter 15% of the excess as an additional credit on line 19.

Line 20

Combine the amounts on line 18 and line 19.

Line 21

Corporations which are not part of an aggregated group for calculating the research credit will have a 100% allocation percentage.

If there were no basic research payments, the percentage of credit on line 21 is the same as the ratio of the corporation's qualified expenses on line 5 to the group's expenses on line 6.

If the group has basic research payments, the percentage of credit attributable to this corporation is altered to take into account the basic research payments made by this corporation and by the group as a whole. The percentage is (line 5 amount plus basic research payments made by this corporation) divided (line 6 amount plus basic research payments made by the entire group).

In either case, carry this figure to four decimal places.

Line 22

The credit attributable to this corporation is the amount on line 20 multiplied by the percentage on line 21. Enter the amount of credit shown here on the credit manager schedule.

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.

Massachusetts Research Credit Used

Line 23

Excise before credit. Corporations not participating in a combined return enter the amount from Form 355, line 6 or Form 355S, line 9. 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 24

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 23 in line 24.

Line 26

If the corporation is not a member of an aggregate group, or if the total excise for the group shown in line 24 is less than or equal to \$25,000, enter the amount from line 23 here. Otherwise, multiply the amount on line 23 by the allocation percentage in line 25.

Line 29

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 29.

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).