

2014 Credit for Increased Research Activities

CONTACTS FOR REFUND OF CREDIT FOR INCREASED RESEARCH ACTIVITIES

Arizona Commerce Authority

•Application forms •Program guidelines

Website: www.azcommerce.com

Program Manager (602) 845-1200

CONTACTS FOR NONREFUNDABLE CREDIT FOR INCREASED RESEARCH ACTIVITIES

Arizona Department of Revenue

•Tax forms and instructions •Information and assistance

Website: www.azdor.gov

Taxpayer assistance (602) 255-3381

From area codes 520 and 928, toll-free (800) 352-4090

General Instructions

NOTE: THE 2014 FORM 308 IS USED BY TAXPAYERS THAT ARE CORPORATIONS, EXEMPT ORGANIZATIONS WITH UNRELATED BUSINESS TAXABLE INCOME (UBTI), S CORPORATIONS OR PARTNERSHIPS. INDIVIDUAL TAXPAYERS MUST USE THE 2014 FORM 308-I.

Arizona Revised Statutes (A.R.S.) § 43-1168 provides a corporate income tax credit for increased research activities in a taxable year; a portion of the current year's excess credit may be refundable to qualified taxpayers.

The credit for increased research activities is in lieu of the solar liquid fuel credit, provided by A.R.S. § 43-1164.02 (claimed on Arizona Form 344), with respect to the same expenses.

The Arizona corporate tax credit is allowed in an amount computed pursuant to Internal Revenue Code (IRC) § 41 with the following exceptions:

- Qualified research includes only research conducted in Arizona. The term "qualified research," for purposes of the Arizona tax credit, means qualified research, as defined in IRC § 41, that is conducted in Arizona and basic research, as defined in IRC § 41, which is conducted in Arizona.
- The amount of the credit is based on the federal regular credit computation method for Arizona qualified research expenses and Arizona basic research payments. Taxpayers CANNOT use the federal alternative credit computation method. The allowable current taxable year credit is a percentage of (a) the excess, if any, of the Arizona qualified research expenses for the taxable year, over the base amount; and (b) the Arizona basic research payments.

For 2014, if the allowable expenses do not exceed \$2,500,000, the allowable credit is 24% of this amount. If the allowable expenses exceed \$2,500,000, the allowable credit amount is \$600,000 plus 15% of the amount of expenses over \$2,500,000, subject to certain limitations.

- If two or more taxpayers, including shareholders of an S corporation and partners in a partnership, share in the eligible expenses, each taxpayer is eligible to receive a proportionate share of the credit.

- The termination provisions of IRC § 41 do not apply.

CORPORATE TAXPAYERS: If two or more members of a unitary group or an Arizona affiliated group incur qualifying expenses, the individual members of the group are not considered separate taxpayers. When a combined return or a consolidated return is filed, the unitary group or the Arizona affiliated group is considered a single taxpayer.

The credit is available to an exempt organization that is subject to corporate income tax on UBTI. The credit must result from the activities that generate UBTI.

REFUND OF 75% OF CURRENT YEAR'S EXCESS CREDIT

If the current taxable year's credit for increased research activities exceeds your income tax liability for the taxable year, a portion of the excess credit may be refundable, if you qualify.

The amount of credit that is refundable is limited to 75% of the excess credit. The excess credit is the current year's credit less the current year's tax liability. The 75% refund is only available for the current year's excess credit for increased research activities. Once the taxpayer files a return with the department, the excess credit for increased research activities is carried forward; therefore, the taxpayer may not claim a refund for that taxable year.

NOTE: Because the refund is calculated after tax liability, it is necessary that you calculate all of your other credits before you can determine the current year's excess credit amount.

Taxpayers must apply to the Arizona Commerce Authority (Commerce) and receive a Certificate of Qualification (Certificate) to receive a refund. Taxpayers must have less than 150 full-time employees to qualify. The refund is the lesser of (a) 75% of the excess credit; or (b) the maximum refund on the Certificate from Commerce. Any additional amount is waived.

If two or more taxpayers, including shareholders of an S corporation and partners in a partnership, share in the eligible expenses, each taxpayer is eligible to claim a proportionate share of the refund. An S corporation must apply for the Certificate on behalf of its shareholders. A partnership must apply for the Certificate on behalf of its partners.

CARRYOVER OF UNUSED CREDIT

If the current taxable year's credit exceeds the taxpayer's tax liability for the taxable year, the taxpayer may carry forward the unused credit to the next fifteen consecutive taxable years. Due to various law changes, the amount that may be carried forward and how it is applied differs depending on the tax year it was earned. Please see the specific instructions for more information on how to calculate the proper carryforward amounts.

NOTE: Taxpayers that elected to receive a refund of 75% of the excess credit cannot carry forward any amount from the year of the refund. Carry forwards from years prior to 2010 or years where the taxpayer did not elect to receive a refund may carryover to the following year.

If you qualify to receive a refund for this taxable year, carryovers of the credit for increased research activities from previous taxable years will be carried over to the following taxable year, subject to the fifteen year carryover period and annual limitations on use of those carryovers.

Specific Instructions

Complete the name and employer identification number (EIN) section at the top of the form. Indicate the period covered by the taxable year. Include the completed form with the tax return.

All returns, statements, and other documents filed with the department require a taxpayer identification number (TIN). The TIN for a corporation, an exempt organization with UBTI, an S corporation or a partnership is the taxpayer's EIN. Taxpayers that fail to include their TIN may be subject to a penalty.

Part 1 - Qualification for Refund of Current Taxable Year's Excess Credit

Line 1 -

If the taxpayer applied to Commerce and received a Certificate related to the credit for increased research activities, check the "Yes" box. Otherwise, check the "No" box and skip line 2.

Line 2 -

If you checked the "Yes" box on line 1, enter the maximum refund amount for taxable year 2014 on your Certificate from Commerce.

Line 3 -

If an entity from which you are claiming a pass through credit for increased research activities applied to Commerce and received a Certificate, check the "Yes" box. Otherwise, check the "No" box, and skip line 4 and line 5.

If you checked the "No" box for both line 1 and line 3, skip Part 6.

NOTE: By checking the "No" boxes for both line 1 and line 3, you are indicating that you will not seek a refund for this taxable year, and instead will carry any excess credit forward. This election cannot be changed on an amended return.

Line 4 -

If you checked the "Yes" box on line 3, enter the name and EIN of the entity that received the Certificate from Commerce on line 4.

Line 5 -

If you checked the "Yes" box on line 3, enter your share of the maximum refund amount for taxable year 2014, from Part 4 of the S corporation's Form 308 or Part 5 of the partnership's Form 308.

Only an exempt organization with UBTI would enter a pass-through amount from an S corporation on line 5.

Part 2 - Current Taxable Year's Credit Calculation

Lines 6 through 8 apply only to corporations (excluding S corporations, personal holding companies, and service organizations). All other taxpayers begin the computation on line 9.

Line 6 -

Corporate taxpayers may be eligible for a "basic research" credit if their payments made in cash to a qualified university or scientific research organization (pursuant to a written contract) for research conducted in Arizona exceed a base period amount. Enter the amount of such payments on line 6.

Line 7 -

Enter the base period amount as defined by IRC § 41(e) that is based on Arizona research activity. The amount on line 7 (but not more than the amount on line 6), although not eligible for the basic research credit, can be treated as contract research expenses on line 12.

Line 9 -

Enter total wages paid or incurred for qualified services performed in Arizona. Do not include the amount of such wages paid to employees that were used in the calculation of the federal work opportunity credit. Wages include any wages paid or incurred to an employee for qualified services performed by such employee. Qualified services consist of engaging in qualified research or engaging in the direct supervision or direct support of research activities that constitute qualified research.

Line 10 -

Enter the cost of supplies paid or incurred for use in the conduct of qualified research in Arizona. Supplies include expenditures for any tangible property other than land or improvements to land, and property of a character subject to the allowance for depreciation.

Line 11 -

Enter the amount paid or incurred to rent or lease the right to use computers in the conduct of qualified research in Arizona.

Line 12 -

Enter the total of:

- (a) Seventy-five percent (.75) of any amount paid or incurred for qualified research performed in Arizona by a qualified research consortium on the taxpayer's behalf. "Qualified research consortium" is any qualifying organization as defined in IRC § 41(b)(3)(C)(ii). Also include 75% of that portion of line 6, basic research payments, paid to a qualified research consortium that does not exceed the line 7 base amount.
- (b) Sixty-five percent (.65) of any amount paid or incurred for qualified research performed in Arizona on the taxpayer's behalf, other than such amounts paid to a qualified research consortium. Prepaid contract research expenses are considered paid in the year the research is actually done. Also include 65% of that portion of line 6, basic research payments, that does not exceed the line 7 base amount, other than amounts paid to a qualified research consortium.

NOTE: If you made basic research payments to an Arizona university under the jurisdiction of the Arizona Board of Regents, you may be entitled to an additional credit. See Arizona Form 346 for details.

Line 14 -

Enter the amount of expenses included on lines 9 through 12 that are related to solar liquid fuel that will be claimed on Arizona Form 344. The credit for increased research activities is in lieu of the solar liquid fuel credit, provided by A.R.S. § 43-1164.02 (claimed on Arizona Form 344), with respect to the same expenses.

Line 16 -

Enter the average annual Arizona gross receipts for the four taxable years preceding the taxable year for which the credit is being determined (the credit year). The taxpayer may be required to annualize gross receipts for any short taxable year.

If 2014 is the first year the taxpayer is in business, the average annual Arizona gross receipts for the preceding taxable years is zero. If the taxpayer has been in business in Arizona for less than four taxable years prior to the credit year, then the average is the sum of annual Arizona gross receipts of the applicable period, divided by the number of taxable years.

Example: ABC Corporation began business in Arizona in 2012. Its annual Arizona gross receipts for 2012 were \$100,000. Its annual Arizona gross receipts for 2013 were \$200,000. Therefore, ABC Corporation's average annual Arizona gross receipts for the 2014 credit year is \$150,000 (\$100,000 plus \$200,000] divided by 2).

Line 17 -**Fixed base percentage**

Use the same type of formulas to compute your fixed-base percentage for Arizona as you would for computing your federal fixed-base percentage. The difference is that you use Arizona qualified research expense and gross receipts amounts instead of federal amounts. Other than that, the calculations are the same. Round off the percentage to the nearest one, one hundredth of one percent (four decimal places).

If the percentage computation involves *de minimis* amounts of gross receipts and qualified expenses in a taxable year or short taxable years are involved, the amounts may be annualized or disregarded. Refer to IRC §§ 41(c)(3) and 41(f)(4) for details.

Existing firms and start-up companies

Arizona's definition of whether an organization is an existing firm or a start-up company is also the same as federal, albeit on an Arizona basis:

- **Existing firms** - An existing firm is one that had both Arizona gross receipts and Arizona qualified research expenses for at least three taxable years beginning after December 31, 1983, and before January 1, 1989. The fixed-base percentage is the ratio that the aggregate Arizona qualified research expenses for all taxable years beginning after 1983 and before 1989, bears to the aggregate Arizona gross receipts for such taxable years.
- **Start-up companies** - A start-up company is one that had both Arizona gross receipts and Arizona qualified research expenses either (1) for the first time in a taxable year beginning after December 31, 1983, or (2) for fewer than three taxable years beginning after 1983 and before 1989.

If the percentage computation involves *de minimis* amounts of gross receipts and qualified expenses in a taxable year or short taxable years are involved, the amounts may be annualized or disregarded. Refer to IRC §§ 41(c)(3) and 41(f)(4) for details.

NOTE: *The maximum percentage that can be entered on line 17 is 16% (.1600).*

Line 20 -

Multiply line 15 by 50% (.50). The base amount cannot be less than 50% of the current year qualified research expenses. This rule applies to both existing and start-up companies.

Lines 23 through 27 -

The way you compute the amount of current year's credit you may receive depends on the amount of expenses you have. To determine your proper credit amount, complete lines 23 through 27 as instructed on the form.

Part 3 - Current Taxable Year's Credit Passed Through From S Corporations and Partnerships**Line 28 -**

Enter the aggregate amount you received as a flow through from Form 308, Part 5, line 38 for each partnership. An exempt organization with UBTI would also include the amount received as a flow through from Form 308, Part 4, line 33 from an S corporation. Include a copy of Form 308 received from each S corporation or partnership with your return.

If you checked the "Yes" box on line 3, complete Part 6 to calculate the amount of the current year's excess credit that is refundable to you.

Complete Parts 7 and/or 8 to compute the available carryover of the credit passed through by S corporations or partnerships from prior taxable years. You should complete Parts 7 and/or 8 only if your allowable credit for increased research activities for prior taxable years exceeded your Arizona income tax liability for those taxable years, and you did not receive a refund of the credit for increased research activities for those taxable years. The carry forward for tax years in which you received a refund of the credit for increased research activities is zero.

Line 29 -

Enter the total of line 27 and line 28. This is your current year's total credit for increased research activities.

Part 4 - S Corporation Credit Election and Shareholder's Share of Credit**Line 30 - S Corporation Credit Election**

S corporations must complete line 30. The S corporation must make an irrevocable election to either claim the current taxable year credit or pass the credit through to its shareholders. The election statement must be signed by one of the officers of the S corporation who is also a signatory to Arizona Form 120S. If the S corporation elects to claim the credit itself, it can skip lines 31 through 35 and complete Parts 6 through 11, as applicable.

Lines 31 through 35 -

If an S corporation elects to pass the credit through to its shareholders, it must also complete lines 31 through 33. If the

S corporation received a Certificate from Commerce, it must also complete line 34. If the S corporation received a pass-through credit from a partnership, and the partnership received a Certificate from Commerce, the S corporation must also complete line 35.

After the S corporation completes Parts 1, 2 and 3, it must complete Part 4, lines 31 through 35, separately for each shareholder. The S corporation must furnish each shareholder with a copy of pages 1 through 4 of Form 308, and a copy of the Certificate, if applicable.

Each exempt organization shareholder must complete Parts 6 through 11, as applicable. All individual S corporation shareholders should complete Arizona Form 308-I.

Part 5 - Partner's Share of Credit

Lines 36 through 40 -

After a partnership completes Parts 1, 2 and 3, it must complete Part 5, lines 36 through 40, separately for each partner. The partnership must furnish each partner with a copy of pages 1 through 4 of Form 308 and a copy of the Certificate, if applicable. Each corporate partner must complete Parts 6 through 11, as applicable. A partner that is an exempt organization with UBTI must complete Parts 6 through 11, as applicable. All individual partners should complete Arizona Form 308-I.

Part 6 - Refundable Portion of the Current Taxable Year's Excess Credit

Complete Part 6 if any of the following apply:

- 1) You are a corporation, and exempt organization with UBTI, or an S corporation that elects to claim the credit, and the "Yes" box on Part 1, line 1 and/or Part 1, line 3, is checked and you elect to receive a refund of up to 75% of your excess credit, limited by the amount on line 2 and/or line 5;
or
- 2) You are a corporate partner in a partnership or an exempt organization with UBTI that is a partner in a partnership, and the "Yes" box on Part 1, line 1 and/or Part 1, line 3, is checked and you elect to receive a refund of 75% of your excess credit, limited by the amount on line 39 and/or line 40;
or
- 3) You are an exempt organization S corporation shareholder, and the "Yes" box on Part 1, line 1 and/or Part 1, line 3, is checked and you elect to receive a refund of 75% of your excess credit, limited by the amount on line 34 and/or line 35.

If you are an individual receiving a pass through from a partnership or an S corporation, you must complete Form 308-I to claim your refund. Include both the entity's Form 308 and your Form 308-I with your individual tax return.

The excess credit is the current taxable year's credit for increased research activities less the current taxable year's tax liability. Carryovers of the credit for increased research activities from

previous taxable years will carryover for possible use in the next taxable year, provided they do not expire this taxable year.

NOTE: *If you complete Part 6 and are receiving a refund, do not complete Part 9 or Part 10.*

Line 41 -

Enter the amount of the current taxable year's credit. Corporations, exempt organizations with UBTI, or S corporations, enter the amount from Part 3, line 29. Exempt organizations with UBTI that are S corporation shareholders, enter the credit from Part 4, line 33. Corporate partners of a partnership or exempt organizations with UBTI that are partners of a partnership, enter the amount from Part 5, line 38.

Line 42a -

Enter the current taxable year's tax, including recapture, from Form 99T, line 8; or Form 120, line 18; or Form 120A, line 10; or Form 120S, line 14; or Form 120X, line 18(c).

Line 42b -

Enter the amount of nonrefundable tax credits from Form 300. Exclude the credit or carryover for increased research activities.

Line 42c -

Enter the current taxable year's credit for increased research activities that will be used to offset the current taxable year's tax liability. Subtract line 42b from line 42a. Enter the difference. If the difference is zero or more, also enter it on Part 11, line 66; also enter it on Form 300, Part 1, line 4, column (a), and Form 300, Part 2, line 36. If the difference is less than zero, enter zero.

Line 43 -

Subtract line 42c from line 41. Enter the difference. If the difference is less than zero, enter zero; no refund is available for this taxable year. This is the current taxable year's excess credit.

Line 44 -

Multiply line 43 by 75% and enter the result. This is your tentative refundable credit.

Line 45 -

Enter the maximum refundable credit. Corporations, exempt organizations with UBTI, or S corporations, enter the amount from Part 1, line 2. S corporations that are eligible for a refund because of a flow through from a partnership, enter the amount from Part 1, line 5. Exempt organizations with UBTI that are S corporation shareholders enter the amount from Part 4, line 34 or line 35. Corporate partners of a partnership or exempt organizations with UBTI that are partners of a partnership, enter the amount from Part 5, line 39 or line 40.

Line 46 -

Enter the lesser of line 44 or line 45. Complete Part 7 and Part 8, only if you have carryovers from taxable years prior to 2014. Otherwise, skip Part 9 and Part 10.

Enter the amount from line 46 on Form 99T, line 12; or Form 120, line 22; or Form 120A, line 14; or Form 120S, line 18; or Form 120X, line 22. On the same line, be sure to check box 308 indicating you are claiming a refundable credit for increased research activities.

CREDIT CARRYOVER

WHAT IS A CONVERSION CARRYOVER?

The allowable amount of carryover of qualified research expenses from years before taxable year 2001 was determined differently than a carryover is ordinarily done. Instead of carrying forward an unused credit amount, taxpayers had to convert each year's qualified research expenses to a credit carryover amount ("conversion carryover"). Any unused qualified research expenses were multiplied by 20%, and the result was carried forward and applied subject to the same additional limitations as any credit for increased research activities. Those additional limitations are explained in the instructions that follow.

Because the conversion carryover arises from years where individuals were ineligible for the credit, S corporations would have no conversion carryover to pass through to their shareholders. The conversion carryover applies only to corporations and S corporations that were using the credit to offset their corporate income tax.

Taxpayers needing to use the conversion calculation may refer to the 2001 Form 308, *Credit for Increased Research Expenses*. This form is available on the department's website at www.azdor.gov.

Part 7 - Available Pre-2003 Credit Carryover

The credit for increased research activities may be carried forward to offset against the tax liability of the next fifteen taxable years. Use Part 7 to calculate the available pre-2003 credit carryover.

After you complete lines 47 through 50, calculate the total of all your carryovers from tax years prior to 2003. Enter this total on line 51, column (d).

Allowable Credit Carryover

There are limitations on how much of your carryover you can use to offset this year's tax. How much you can use depends on the year from which the carryover arose. In Part 9 and Part 10, you will be applying these limitations to determine the proper carryover amounts.

Remember, if you have other credits, your usable amount of credit from increased research activities may be limited further. You will be applying these limitations when you complete Form 300, *Nonrefundable Corporate Tax Credits and Recapture*.

Part 8 - Available Post-2002 Credit Carryover

The credit for increased research activities may be carried forward and offset against the next fifteen taxable years. Use Part 8 to calculate the available post-2002 credit carryover.

After you complete lines 53 through 62, calculate the total of all your carryovers from tax years after 2002. Enter this total on line 63, column (d).

REMINDER: If you received a refund of the credit for increased research activities related to taxable years 2010, 2011, 2012, or 2013, no carryover is available from those years. In this case, enter zero in column (d) for those tax years.

Part 9 - Limitation of Pre-2003 Credit Carryover

NOTE: If you completed Part 6 and are receiving a refund, do not complete Part 9.

The total amount of credit carryovers that originated in taxable year 2002 and the preceding years that you can use to offset this year's tax liability is limited. The total amount of pre-2003 credit carryforward cannot be more than your current year's income tax liability or \$500,000, minus the current year's credit for increased research activities.

Use lines 64a through 64f to calculate the amount of pre-2003 carryovers that you can use. Complete these lines as instructed on the form.

Part 10 - Limitation of Post-2002 Credit Carryover

NOTE: If you completed Part 6 and are receiving a refund, do not complete Part 10.

The total amount of credit carryovers originating in 2003 and subsequent years that you can use to offset this year's tax liability can be no more than the current year's tax liability less the current taxable year's credit for increased research activities.

Use lines 65a through 65e to calculate the amount of post-2002 carryovers that you can use. Complete these lines as instructed on the form.

Part 11 - Total Available Nonrefundable Credit

Complete this section to compute the total available nonrefundable credit for the taxable year. The total available nonrefundable credit is the sum of the credit for the current taxable year's increased research activities and the available credit carryover(s).

Line 66 -

If you completed Part 6 and are receiving a refund, enter the amount from Part 6, line 42c.

Corporations (including S corporations that elected to claim the credit) and exempt organizations with UBTI not receiving a refund in Part 6 - enter the current year's credit from Part 3, line 29.

Exempt organizations with UBTI that are S corporation shareholders not receiving a refund in Part 6 - enter the credit from Part 4, line 33.

Corporate partners of a partnership or exempt organizations with UBTI that are partners of a partnership not receiving a refund in Part 6 - enter the credit from Part 5, line 38.

This is the current taxable year's credit for increased research activities.

Line 67 -

If you completed Part 6 and are receiving a refund, enter zero. Otherwise, enter your pre-2003 credit carryover amount from Part 9, line 64f.

Line 68 -

If you completed Part 6 and are receiving a refund, enter zero. Otherwise, enter your post-2002 credit carryover amount from Part 10, line 65e.

Line 69 -

Add the amounts from lines 66, 67, and 68. This is the total available credit for increased research activities that may be applied to the current taxable year's tax liability. Enter the total here and on Form 300, Part 1, line 4, column (c).