

2011 Credit for Increased Research Activities

CONTACTS FOR REFUND OF CREDIT FOR INCREASED RESEARCH ACTIVITIES

**Arizona Commerce Authority
(formerly the Arizona Department of Commerce)**

•Application forms •Program guidelines

Internet home page: www.azcommerce.com

Program Manager (602) 845-1200

CONTACTS FOR NONREFUNDABLE CREDIT FOR INCREASED RESEARCH ACTIVITIES

Department of Revenue

•tax forms and instructions •information and assistance

Internet home page: www.azdor.gov

Taxpayer assistance (602) 255-3381

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

Hearing impaired TDD user

Phoenix (602) 542-4021

From area codes 520 and 928, toll-free (800) 397-0256

General Instructions

NOTE: THE 2011 FORM 308 IS USED BY TAXPAYERS THAT ARE CORPORATIONS, S CORPORATIONS OR PARTNERSHIPS. INDIVIDUAL TAXPAYERS MUST USE THE 2011 FORM 308-I.

ARS § 43-1168 provides a corporate income tax credit for increased research activities in a taxable year. For taxable years beginning prior to January 1, 2001, this credit was only available to corporations and S corporations using the credit to offset tax incurred at the corporate level. It was not available for S corporations or partnerships to pass through to their shareholders or partners, and it was not available to individual taxpayers. This changed effective for taxable years beginning on or after January 1, 2001, and now S corporation and partnerships can pass the credit through to shareholders and partners (ARS § 43-1074.01). For taxable years beginning from and after December 31, 2009, 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, under ARS § 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 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 2011, if the allowable expenses do not exceed \$2,500,000, the allowable credit is 24 percent of this amount. If the allowable expenses exceed \$2,500,000, the allowable credit amount is \$600,000 plus 15 percent 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.

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 taxable years beginning from and after December 31, 2009, 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 and carries the excess credit for increased research activities forward, the taxpayer may not claim a refund later 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 (formerly the Arizona Department of Commerce) and receive a Certificate of Qualification 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 of Qualification from the Arizona Commerce Authority. 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 of Qualification on behalf of its shareholders. A partnership must apply for the Certification of Qualification on behalf of its partners.

Carryovers from 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.

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.

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.

Specific Instructions

Complete the name and taxpayer identification number section at the top of the form. Indicate the period covered by the taxable year. Attach the completed form to the tax return.

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

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

If the taxpayer applied to the Arizona Commerce Authority and received a Certificate of Qualification 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 2011 on your Certificate of Qualification from the Arizona Commerce Authority.

Part II - Current Taxable Year's Credit Calculation

Lines 3 through 5 apply only to corporations (excluding S corporations, personal holding companies, and service organizations). All other taxpayers begin the computation on line 6.

Line 3 -

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 exceeds a base period amount. Enter the amount of such payments on line 3.

Line 4 -

Enter the base period amount as defined by IRC § 41(c) that is based on Arizona research activity. The amount on line 4 (but not more than the amount on line 3), although not eligible for the basic research credit, can be treated as contract research expenses on line 9.

Line 6 -

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 7 -

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 8 -

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

Line 9 -

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 percent of that portion of line 3, basic research payments, paid to a qualified research consortium that does not exceed the line 4 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 percent of that portion of line 3, basic research payments, that does not exceed the line 4 base amount, other than amounts paid to a qualified research consortium.

Line 11 -

Enter the amount of expenses included on lines 6 through 9 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, under ARS § 43-1164.02 (claimed on Arizona Form 344) with respect to the same expenses.

Line 13 -

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 2011 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 2009. Its annual Arizona gross receipts for 2009 were \$100,000. Its annual Arizona gross receipts for 2010 were \$200,000. Therefore, ABC Corporation's average annual Arizona gross receipts for the 2011 credit year is \$150,000 ([\$100,000 plus \$200,000] divided by 2).

Line 14 -

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 14 is 16 percent (.1600).*

Line 17 -

Multiply line 12 by 50 percent (.50). The base amount cannot be less than 50 percent of the current year qualified research expenses. This rule applies both to existing and start-up companies.

Lines 20 through 24 -

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 20 through 24 as instructed on the form.

Part III - S Corporation Credit Election and Shareholder's Share of Credit

Line 25 - S Corporation Credit Election

S corporations must complete line 25. 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 the Form 120S. If the S corporation elects to claim the credit itself, it can skip lines 26 through 29 and complete Parts V through X, as applicable.

Lines 26 through 29 -

If an S corporation elects to pass the credit through to its shareholders, it must also complete lines 26 through 28. If the S corporation received a Certificate of Qualification from the Arizona Commerce Authority, it must also complete line 29.

After the S corporation completes Parts I and II, it must complete Part III, lines 26 through 29, separately for each shareholder. The S corporation must furnish each shareholder with a copy of the completed Form 308 and the Certificate of Qualification, if applicable.

Part IV - Partner's Share of Credit

Lines 30 through 33 -

After a partnership completes Parts I and II, it must complete Part IV, lines 30 through 33, separately for each partner. The partnership must furnish each partner with a copy of the completed Form 308 and the Certificate of Qualification, if applicable. Each corporate partner must complete Parts V through X, as applicable.

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

Complete Part V if either of the following apply to you:

- 1) you are a corporation or an S corporation that elects to claim the credit, and the "Yes" box on Part I, line 1, is checked and you elect to receive a refund of up to 75% of your excess credit, limited by the amount on line 2;
or
- 2) you are a corporate partner in a partnership, and the "Yes" box on Part I, line 1, is checked and you elect to receive a refund of 75% of your excess credit, limited by the amount on line 33.

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 V and are receiving a refund, do not complete Part VIII or Part IX.*

Line 34 -

Enter the amount of the current taxable year's credit. Corporations or S Corporations, enter the amount from

Part II, line 24. Corporate partners of a partnership, enter the amount from Part IV, line 32.

Line 35a -

Enter the current taxable year's tax, including recapture, from Form 120, line 18; or Form 120A, line 10; or Form 120S, line 14; or Form 120X, line 18(c).

Line 35b -

Enter the current taxable year's Clean Elections Fund Tax Reduction from Form 120, line 19; or Form 120A, line 11; or Form 120S, line 15; or Form 120X, line 19(c).

Line 35c -

Subtract line 35b from line 35a. Enter the difference.

Line 35d -

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

Line 35e -

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 35d from line 35c. Enter the difference. If the difference is zero or more, also enter it on Form 300, Part I, line 5, and Form 300, Part II, line 34. If the difference is less than zero, enter zero.

Line 36 -

Subtract line 35e from line 34. Enter the difference. If the result is less than zero, enter zero; no refund is available for this taxable year. This is the current taxable year's excess credit.

Line 37 -

Multiply line 36 by 75% and enter the result. This is your tentative refundable credit.

Line 38 -

Enter the maximum refundable credit. Corporations or S corporations, enter the amount from Part I, line 2. Corporate partners of a partnership, enter the amount from Part IV, line 33.

Line 39 -

Enter the lesser of line 37 or line 38. Complete Part VI and Part VII, if you have carryovers from years prior to 2011. Skip Part VIII and Part IX.

Enter the amount from line 39 on Form 120, line 25; or Form 120A, line 17; or Form 120S, line 21; or Form 120X, line 25. 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: www.azdor.gov.

Part VI - Available Pre-2003 Credit Carryover

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

After you complete lines 40 through 46, calculate the total of all your carryovers that come from tax years prior to 2003. Enter this total on line 47, 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 VIII and Part IX, 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 VII - 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 VII to calculate the available post-2002 credit carryover. After you complete lines 48 through 55, calculate the total of all your carryovers that come from tax years after 2002. Enter this total on line 56, column (d).

Part VIII - Limitation of Pre-2003 Credit Carryover

REMINDER: Entities other than corporations and S corporations using the credit at the corporate level **do not** have credit carryovers from years prior to 2001.

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

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 57a through 57f to calculate the amount of pre-2003 carryovers that you can use. Complete these lines as instructed on the form.

Part IX - Limitation of Post-2002 Credit Carryover

NOTE: *If you completed Part V and are receiving a refund, do not complete Part IX.*

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 58a through 58e to calculate the amount of post-2002 carryovers that you can use. Complete these lines as instructed on the form.

Part X - 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 59 -

If you completed Part V and are receiving a refund, enter the amount from Part V, line 35e.

Corporations (including S corporations that elected to claim the credit) not receiving a refund in Part V - enter the current year's credit from Part II, line 24.

Corporate partners of a partnership not receiving a refund in Part V - enter the credit from Part IV, line 32.

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

Line 60 -

If you completed Part V and are receiving a refund, enter zero. Otherwise, enter your pre-2003 credit carryover amount from Part VIII, line 57f.

Line 61 -

If you completed Part V and are receiving a refund, enter zero. Otherwise, enter your post-2002 credit carryover amount from Part IX, line 58e.

Line 62 -

Add the amounts from lines 59, 60, and 61. 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 I, line 5.