

2005 Credit for Increased Research Expenses

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General Instructions

NOTE: THE 2005 FORM 308 IS USED BY TAXPAYERS THAT ARE CORPORATIONS, S CORPORATIONS OR PARTNERSHIPS. INDIVIDUAL TAXPAYERS MUST USE THE 2005 FORM 308-I.

ARS §§ 43-1074.01 and 43-1168 provide nonrefundable individual and corporate income tax credits for increased research activities in a taxable year. The credit for increased research activities applies to taxable years beginning from and after December 31, 2000.

The Arizona 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.

If the allowable expenses do not exceed \$2,500,000, the allowable credit is 20 percent of this amount. If the allowable expenses exceed \$2,500,000, the allowable credit amount is \$500,000 plus 11 percent of the amount of expenses over \$2,500,000, subject to certain limitations. The allowable credit limitation is the *lesser* of the amount computed above, or: (a) \$1,500,000 (for taxable years beginning from and after December 31, 2000, and before January 1, 2002) or (b) \$2,500,000 (for taxable years beginning from and after December 31, 2001, and before January 1, 2003).

- 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.

CARRYOVER OF UNUSED CREDIT

If the current taxable year credit exceeds the taxpayer's tax liability for the taxable year, the taxpayer may carry forward the unused credit to the next 15 consecutive taxable years.

LIMITATION ON USE OF CARRYOVERS FROM TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 2000, AND BEFORE JANUARY 1, 2003: The amount of the credit carryover that may be used in any taxable year is the LESSER OF: (a) the tax liability, or (b) \$500,000, MINUS (c) the current year credit for increased research activities (regardless of the amount of the current year credit that is claimed on the tax return). [If the current year credit is \$500,000 or more, the taxpayer cannot use the credit carryover in that taxable year. **CORPORATE TAXPAYERS:** If the current year credit is less than \$500,000, the limitation on use applies to the aggregate of the credit for increased research activities carryover and the conversion credit carryover.]

LIMITATION ON USE OF CARRYOVERS FROM TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 2002: The amount of credit carryover that may be used in any taxable year is limited to the amount by which the tax liability exceeds the current year credit for increased research activities.

CORPORATIONS AND S CORPORATIONS ONLY

A. CONVERSION OF CARRYOVER OF EXCESS QUALIFIED RESEARCH EXPENSES TO A CREDIT CARRYOVER

Corporate taxpayers that have a carryover of excess qualified research expenses (computed under the provisions of A.R.S. § 43-1168 for taxable years beginning prior to January 1, 2001) may convert the excess expense carryover into a credit carryover. The conversion credit carryover is equal to 20 percent of the allowable carryover of excess qualified research expenses. The conversion computation is made separately for each taxable year prior to taxable year 2001 in which the taxpayer incurred excess qualified research expenses.

The conversion credit carryover may be carried forward to not more than 15 taxable years from the taxable year in which the excess qualified research expenses were incurred. The first taxable year beginning after December 31, 2000, is the first taxable year in which the conversion credit carryover may be used.

B. LIMITATIONS ON THE USE OF THE CONVERSION CREDIT CARRYOVER

The amount of conversion credit carryover that may be used in any taxable year is the LESSER OF: (a) the tax liability, or (b) \$500,000, MINUS (c) the current year credit for increased research activities (regardless of the amount of the current year credit that is claimed on the tax return). [If the current year credit for increased research activities is \$500,000 or more, the taxpayer cannot use the conversion credit carryover in that taxable year. If the current year credit is less than \$500,000, the limitation on use applies to the aggregate of the credit for increased research activities carryover (from taxable years beginning from and after December 31, 2000, through December 31, 2002) and the conversion credit carryover.]

DOES A TAXPAYER HAVE TO MAKE OTHER ADJUSTMENTS TO ARIZONA GROSS INCOME OR TO THE ARIZONA TAX CREDIT FOR INCREASED RESEARCH ACTIVITIES?

- Arizona statutes do not require an addition to Arizona gross income for the amount of qualified research expenses equal to the amount of the allowable Arizona credit for increased research expenses for the taxable year.
- If the taxpayer reduces the amount of the deduction for qualified research expenses in the computation of federal taxable income, Arizona statutes do not allow a subtraction from Arizona gross income for the amount of the expense reduction.
- If the taxpayer adjusts the federal asset basis of capitalized research expenses and reduces the amount of amortization deductible in the computation of federal taxable income, Arizona statutes do not allow a subtraction from Arizona gross income for additional amortization.
- If the taxpayer claims a reduced federal credit for increased research expenses and claims the Arizona credit for increased research expenses, Arizona statutes do not require the taxpayer to reduce the Arizona credit for increased research expenses in a manner similar to the federal reduction method.

Specific Instructions

Complete the name and taxpayer identification number section at the top of the form. Indicate the period covered by the taxable year (in an MM/DD/YYYY format). 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 - Current Taxable Year Credit for Increased Research Expenses

Lines 1 through 3 apply only to corporations (excluding S corporations, personal holding companies and service organizations). All other taxpayers begin the computation on line 4.

Line 1 -

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 1.

Line 2 -

Enter the base period amount as defined by IRC § 41(c) that is based on Arizona research activity. The amount on line 2 (but not more than the amount on line 1), although not eligible for the basic research credit, can be treated as contract research expenses on line 7.

Line 4 -

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 5 -

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 6 -

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

Line 7 -

Enter the total of:

- 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 1, basic research payments paid to a qualified research consortium that does not exceed the line 2 base amount.
- 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 1, basic research payments that does not exceed the line 2 base amount, other than amounts paid to a qualified research consortium.

Line 9 -

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.

Line 10 -

Round off the percentage to the nearest one, one hundredth of one percent (four decimal places). Compute the fixed-base percentage as follows:

- **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.

Fixed-Base Percentages for Taxable Years Beginning After 1993 in Which Start-Up Companies Incurred Arizona Qualified Research Expenses	
Taxable Year After 1993	Percentages for Taxable Years After 1993
1st through 5th	3 percent
6th	Divide the aggregate Arizona qualified research expenses for 4th and 5th taxable years by the aggregate Arizona gross receipts for 4th and 5th taxable years. Multiply the result by 1/6 (.1667).
7th	Divide the aggregate Arizona qualified research expenses for 5th and 6th taxable years by the aggregate Arizona gross receipts for 5th and 6th taxable years. Multiply the result by 1/3 (.3333).
8th	Divide the aggregate Arizona qualified research expenses for 5th through 7th taxable years by the aggregate Arizona gross receipts for 5th through 7th taxable years. Multiply the result by 1/2 (.50).
9th	Divide the aggregate Arizona qualified research expenses for 5th through 8th taxable years by the aggregate Arizona gross receipts for 5th through 8th taxable years. Multiply the result by 2/3 (.6667).
10th	Divide the aggregate Arizona qualified research expenses for 5th through 9th taxable years by the aggregate Arizona gross receipts for 5th through 9th taxable years. Multiply the result by 5/6 (.8333).
All years after 10th	Divide the aggregate Arizona qualified research expenses for any 5 taxable years selected by the taxpayer from among the 5th through 10th taxable years by the aggregate Arizona gross receipts for the selected taxable years.

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 10 is 16 percent (.16).

Line 13 -

Multiply line 8 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.

Line 16 -

Calculate the allowable credit amount according to the instructions in the table below. Enter the result.

Calculation of Current Taxable Year's Credit [taxable years beginning from and after December 31, 2002, through December 31, 2005]	
If the amount on line 15 is:	Credit Calculation
Less than or equal to \$2,500,000	Multiply the amount on line 15 by 20 percent (.20)
more than \$2,500,000	\$500,000 plus 11 percent (.11) of the amount over \$2,500,000.

Part II – S Corporation Credit Election and Shareholder's Share of Credit

Line 17 - S Corporation Credit Election

S corporations must complete line 17. 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. NOTE: The S corporation cannot pass the conversion credit carryover through to its shareholders.

Lines 18 through 20 -

If the S corporation elects to pass the credit through to its shareholders, it must also complete lines 18 through 20.

The S corporation must complete Part I. Then, complete Part II, lines 18 through 20, separately for each shareholder. The S corporation must furnish each shareholder with a copy of the completed Form 308, page 1.

Part III - Partner's Share of Credit

Lines 21 through 23 -

The partnership must complete Part I. Then, complete Part III, lines 21 through 23, separately for each partner. The partnership must furnish each partner with a copy of the completed Form 308, page 1.

Part IV – Available Credit Carryover (Credit for Increased Research Activities) From Taxable Years Beginning From and After December 31, 2000 Through December 31, 2002

Part IV applies only to corporations and S corporations that have a carryover of the credit for increased research activities, which is effective for taxable years beginning from and after December 31, 2000. Since the credit for increased research activities applies only to taxable years beginning from and after December 31, 2000, there is no available credit carryover from taxable years beginning prior to January 1, 2001. Calculate the total available carryover of the credit for increased research activities FROM TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2000, THROUGH DECEMBER 31, 2002, on page 2, Part IV, lines 24 through 29.

Corporate partners of a partnership should complete Part IV

only if their allowable credit for increased research activities for prior taxable years exceeded their Arizona income tax liability for those taxable years. Since the credit applies to taxable years beginning from and after December 31, 2000, there is no available carryover of this credit from taxable years beginning prior to January 1, 2001.

Each corporate partner must complete Part IV for the computation of the available carryover of the credit passed through by the partnership.

Enter the applicable taxable year(s) in column (a) on lines 24 through 28. In column (b), enter the credit originally computed for that taxable year. In column (c), enter the amount of the credit from that taxable year which has already been used or has expired. Subtract the amount in column (c) from column (b) and enter the difference in column (d). Add the amounts entered on lines 24 through 28 in column (d). Enter the total on line 29, column (d). This is the total credit carryover available for the current taxable year.

Part V – Available Credit Carryover (Credit for Increased Research Activities) From Taxable Years Beginning From and After December 31, 2002

Calculate the total available carryover of the credit for increased research activities FROM TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2002, on page 2, Part V, lines 30 through 45.

Corporate partners of a partnership should complete Part V only if their allowable credit for increased research activities for taxable years beginning from and after December 31, 2002, exceeded their Arizona income tax liability for those taxable years.

Each corporate partner must complete Part V for the computation of the available carryover of the credit passed through by the partnership.

Enter the applicable taxable year(s) in column (a) on lines 30 through 44. In column (b), enter the credit originally computed for that taxable year. In column (c), enter the amount of the credit from that taxable year which has already been used or has expired. Subtract the amount in column (c) from column (b) and enter the difference in column (d). Add the amounts entered on lines 30 through 44 in column (d). Enter the total on line 45, column (d). This is the total credit carryover available for the current taxable year.

Part VI – Conversion of Excess Qualified Research Expenses (QRE) Carryover to Credit Carryover

Part VI applies only to corporations and S corporations that incurred excess qualified research expenses in taxable years beginning prior to January 1, 2001, for the research and development expenses credit. Partnerships should not complete Part VI.

The conversion computation is made separately for each taxable year prior to taxable year 2001 in which the taxpayer incurred excess qualified research expenses.

Column (a): Enter the applicable taxable year(s) on lines 46 through 53.

Column (b): Enter the amount of excess QRE originally computed for that taxable year.

Column (c): Enter the amount of the excess QRE from that taxable year which has already been used.

Column (d): Subtract the amount in column (c) from column (b). Enter the difference in column (d). Add the amounts entered on lines 46 through 53 in column (d). Enter the total on line 54, column (d).

Column (e): Multiply the amount in column (d) by 20 percent (.20). Enter the result in column (e). Add the amounts entered on lines 46 through 53 in column (e). Enter the total on line 54, column (e). This is the total available carryover of excess QRE to be converted to a credit carryover in Part VII.

Did the Taxpayer Have Excess Qualified Research Expenses in a Taxable Year Beginning Prior to January 1, 2001 [for Column (b)]?

Under the prior corporate research tax credit provisions, qualified research expenses that exceeded the maximum allowable credit in a taxable year could be carried forward for not more than 15 taxable years.

The amount of qualified research expenses in excess of the maximum allowable credit is determined by subtracting the total qualified research expenses used to compute the maximum allowable credit from the qualified research expenses in excess of the base amount.

Use the following examples to determine whether the taxpayer had excess qualified research expenses in a taxable year prior to 2001 [the amount to enter in column (b)].

EXAMPLE 1 (STANDARD CREDIT COMPUTATION): Corporation R incurs \$2,500,000 in qualified research expenses and \$1,500,000 in basic research payments for the taxable year ending March 31, 2001. This is the second taxable year in which the taxpayer is claiming the credit, so the maximum allowable credit for this taxable year is \$250,000.

The basic research payment credit computation and the qualified research expense credit computation, as provided by IRC § 41, are shown separately in an abbreviated format to illustrate the excess qualified research expense computation.

Basic Research Payment (BRP) Credit Computation		
Basic research payments		\$ 1,500,000.00 *
Qualified organization base period amount	-	600,000.00
Excess BRP	=	900,000.00
	x	.20
Computed BRP credit	=	\$ 180,000.00
* \$600,000 of the \$1,500,000 in basic research payments incurred by the taxpayer are treated as contract research expenses for the qualified research expense credit computation as provided by IRC § 41.		

Qualified Research Expense (QRE) Credit Computation		
Qualified research expenses		\$ 2,500,000.00
Contract research expenses (65%)	+	390,000.00
Total QRE	=	2,890,000.00
Base amount	-	1,700,000.00
Excess QRE	=	1,190,000.00
	x	.20
Computed QRE credit	=	\$ 238,000.00

Allowable Research Credit		
Total computed research credit (BRP + QRE)	=	\$ 418,000.00
This is the second taxable year in which the taxpayer is claiming the credit, and, therefore, the maximum allowable credit is \$ 250,000.00.		
Maximum allowable credit (BRP + QRE)	=	\$ 250,000.00

Computation of Excess QRE Subject to Carryforward		
Maximum allowable credit (QRE of \$1,250,000 x .20)	=	\$ 250,000.00
QRE in excess of base amount (excess BRP of \$900,000 + excess QRE of \$1,190,000)	=	\$ 2,090,000.00
QRE used to compute maximum allowable credit	-	1,250,000.00
QRE in excess of maximum allowable credit	=	\$ 840,000.00
Corporation R has \$840,000 of excess QRE in the taxable year ending March 31, 2001, that are available to be carried forward to compute the maximum allowable credit in succeeding taxable years.		

The qualified research expenses in excess of the base amount MINUS the total qualified research expenses used to compute the maximum allowable credit for the taxable year EQUALS the amount of excess qualified research expenses for the taxable year that is available to be carried forward by the taxpayer. The amount of qualified research expenses used to compute the maximum allowable credit for the taxable year in which a taxpayer claims the credit is:

- first taxable year - \$500,000.
- second taxable year - \$1,250,000.
- third taxable year - \$2,000,000.
- each taxable year after the third taxable year - \$2,500,000.

EXAMPLE 2 (ALTERNATIVE CREDIT COMPUTATION): Corporation R incurs \$3,500,000 in qualified research expenses and \$1,500,000 in basic research payments for the taxable year ending July 31, 2001. This is the second taxable year in which the taxpayer is claiming the credit, so the maximum allowable credit for this taxable year is \$250,000.

The basic research payment credit computation and the qualified research expense credit computation, as provided by IRC § 41, are shown separately in an abbreviated format to illustrate the excess qualified research expense computation.

Basic Research Payment (BRP) Credit Computation		
Basic research payments		\$ 1,500,000.00 *
Qualified organization base period amount	-	600,000.00
Excess BRP	=	900,000.00
	x	.20
Computed BRP credit	=	\$ 180,000.00
* \$600,000 of the \$1,500,000 in basic research payments incurred by the taxpayer are treated as contract research expenses for the qualified research expense credit computation as provided by IRC § 41.		

Qualified Research Expense (QRE) Credit Computation		
Qualified research expenses		\$ 3,500,000.00
Contract research expenses (65%)	+	390,000.00
Total QRE	=	\$ 3,890,000.00
Average annual gross receipts \$ 16,000,000.00		
Tier 1 credit:		
QRE (equal to 1.5% of average annual gross receipts)		\$ 240,000.00
Base amount (1% of average annual gross receipts)	-	160,000.00
Excess QRE	=	80,000.00
	x	.0265
Computed tier 1 QRE credit	=	\$ 2,120.00
Tier 2 credit:		
QRE (equal to 2% of average annual gross receipts)		\$ 320,000.00
Base amount (1.5% of average annual gross receipts)	-	240,000.00
Excess QRE	=	80,000.00
	x	.032
Computed tier 2 QRE credit	=	\$ 2,560.00
Tier 3 credit:		
QRE		\$ 3,890,000.00
Base amount (2% of average annual gross receipts)	-	320,000.00
Excess QRE	=	3,570,000.00
	x	.0375
Computed tier 3 QRE credit	=	\$ 133,875.00
Total computed research credit (BRP + QRE)	=	\$ 318,555.00

Allowable Research Credit		
Total computed research credit (BRP + QRE)	=	\$ 318,555.00
This is the second taxable year in which the taxpayer is claiming the credit, and, therefore, the maximum allowable credit is \$ 250,000.00.		
Maximum allowable credit (BRP + QRE)	=	\$ 250,000.00

Computation of Excess QRE Subject to Carryforward		
Maximum allowable credit (BRP of \$180,000 + QRE of \$70,000)	=	\$ 250,000.00 **
** BRP of \$900,000 (\$900,000 x .20 = \$180,000) + QRE of \$1,901,867 [(\$80,000 x .0265 = \$2,120) + (\$80,000 x .032 = \$2,560) + (\$1,741,867 x .0375 = \$65,320)]		
QRE in excess of base amount [excess BRP of \$900,000 + excess QRE of \$3,410,000 (\$3,570,000 - \$160,000)]	=	\$ 4,310,000.00
QRE used to compute maximum allowable credit (BRP of \$900,000 + QRE of \$1,901,867)	-	2,801,867.00
QRE in excess of maximum allowable credit	=	\$ 1,508,133.00
Corporation R has \$1,508,133 of excess QRE in the taxable year ending July 31, 2001, that are available to be carried forward to compute the maximum allowable credit in succeeding taxable years.		

The qualified research expenses in excess of the base amount MINUS the total qualified research expenses used to compute the maximum allowable credit for the taxable year EQUALS the amount of excess qualified research expenses for the taxable year that is available to be carried forward by the taxpayer. The qualified research expenses in excess of the base amount for a taxable year is the total of the amount from the Form 308, Part II, line 21 and the amount from Part II, line 40, MINUS the total of the amount from Part II, line 32, and the amount from Part II, line 37. [Refer to the 1996 through 2000 Forms 308 to make the computation].

The maximum allowable credit amounts for the taxable year in which a taxpayer claims the credit are:

- first taxable year - \$100,000.
- second taxable year - \$250,000.
- third taxable year - \$400,000.
- each taxable year after the third taxable year - \$500,000.

What is the Amount of Excess QRE Previously Used to Compute a Credit in Taxable Years Beginning Prior to January 1, 2001 [for Column (c)]?

Under the prior corporate research tax credit provisions, qualified research expenses (QRE) that exceeded the maximum allowable credit in a taxable year could be carried forward for not more than 15 taxable years.

Was the computed credit for current taxable year QRE less than the maximum allowable credit for the current taxable year? If so, the amount of the excess QRE carryover used cannot exceed the amount of expenses required to compute a credit equal to the difference between the computed credit for current taxable year QRE and the maximum credit for the current taxable year.

Use the following examples to compute the amount to enter in column (c).

- Taxpayers that used the **standard credit computation** should compute the amount according to **example 1**.
- Taxpayers that used the **alternative credit computation** should compute the amount according to **example 2**.

EXAMPLE 1 (STANDARD CREDIT COMPUTATION):

Taxpayer F, a fiscal year basis taxpayer, has a \$700,000 carryover of excess QRE from its taxable year 1999 (taxable year ending May 31, 2000). The credit for current taxable year QRE for the taxable year 2000 (taxable year ending May 31, 2001) is \$150,000. This is the second taxable year in which taxpayer F is claiming the credit, so the maximum credit is \$250,000.

Taxpayer F may only use the amount of expenses required to compute a credit equal to the difference between the credit for current taxable year QRE and the maximum credit for the taxable year. Therefore, taxpayer F may only use \$500,000 of its \$700,000 carryover from the taxable year 1999. This is the amount of expenses required to compute a credit of \$100,000 (\$500,000 X .20 = \$100,000), which is equal to the difference between the credit for current taxable year QRE (\$150,000) and the maximum credit for the taxable year (\$250,000).

EXAMPLE 2 (ALTERNATIVE CREDIT COMPUTATION):

Taxpayer H, a fiscal year basis taxpayer, has a \$3,900,000 carryover of excess QRE from its taxable year 1999 (taxable year ending August 31, 2000). The credit for current taxable year QRE for the taxable year 2000 (taxable year ending August 31, 2001) is \$150,000. This is the second taxable year in which taxpayer H is claiming the credit, so the maximum credit is \$250,000.

Taxpayer H may only use the amount of expenses required to compute a credit equal to the difference between the credit for current taxable year QRE and the maximum credit for the taxable year. Therefore, taxpayer H may only use \$2,666,667 of its \$3,900,000 carryover from the taxable year 1999. This is the amount of expenses required to compute a credit of \$100,000 (\$2,666,667 X .0375 = \$100,000), which is equal to the difference between the credit for current taxable year QRE (\$150,000) and the maximum credit for the taxable year (\$250,000).

Part VII – Available Conversion Credit Carryover

Part VII applies only to corporations and S corporations that incurred excess qualified research expenses in taxable years beginning prior to January 1, 2001, for the research and development expenses credit. Partnerships should not complete Part VII.

The conversion credit carryover can be used by corporate taxpayers that had a carryover of excess qualified research expenses from taxable years beginning prior to January 1, 2001, under the prior corporate research credit provisions. AN S CORPORATION CANNOT PASS ITS CONVERSION CREDIT CARRYOVER THROUGH TO ITS SHAREHOLDERS.

The conversion credit carryover may be carried forward to not more than 15 taxable years from the taxable year in which the excess qualified research expenses were incurred. The first taxable year beginning after December 31, 2000, is the first taxable year in which the conversion credit carryover may be used.

Column (a): enter the taxable year from which the conversion credit was carried forward on lines 55 through 62.

Column (b): enter the amount from column (e) in Part VI for the taxable year on lines 55 through 62.

Column (c): enter the amount of conversion credit carryover previously used or expired on lines 55 through 62.

Column (d): subtract the amount in column (c) from the amount in column (b) on lines 55 through 62. Enter the difference. Add the amounts in column (d) on lines 55 through 62 and enter the total on line 63.

Part VIII – Total Available Credit

Part VIII applies only to corporations and S corporations. Complete this section to compute the total available credit for the taxable year. The total available credit is the sum of the credit for current taxable year qualified research expenses and the available credit carryover(s).

Line 64 -

Corporations (including S corporations that elected to claim the credit) - Enter the current year's credit from Part I, line 16.

Corporate partners of a partnership - Enter the credit from Part III, line 23.

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

Line 65 -

Enter the amount from Part IV, line 29, column (d). This is the total available credit carryover for the credit for increased research activities from taxable years beginning from and after December 31, 2000, through December 31, 2002.

Line 66 -

Enter the amount from Part V, line 45, column (d). This is the total available credit carryover for the credit for increased research activities from taxable years beginning from and after December 31, 2002.

Line 67 -

Enter the amount from Part VII, line 63, column (d). This is the total available conversion credit carryover.

Line 68 -

Corporations and S corporations (including S corporations that elected to claim the credit) - add lines 64, 65, 66, and 67. Enter the total here and on Form 300, Part I, line 6.

This is the total available credit for increased research activities which may be applied to the current taxable year's tax liability. CORPORATE TAXPAYERS: THE LIMITATIONS ON THE USE OF THE CREDIT CARRYOVERS FOR TAXABLE YEAR 2005 TAX RETURNS WILL BE COMPUTED ON FORM 300.