

1996 Research Credit

3523

Attach to your California tax return.

Name(s) as shown on return	Social security or California corporation number
	Federal employer identification number (FEIN)

Part I Computation of the Credit. Read the instructions before completing this form.

Line 1 through line 4 are to be completed only by corporations. Individuals, partnerships, estates and trusts, begin on line 5.

1	Basic research payments paid or incurred during the income year. See instructions	1	_____
2	Base period amount. See instructions	2	_____
3	Subtract line 2 from line 1. If less than zero, enter -0-	3	_____
4	Multiply line 3 by 12% (.12)	4	_____
Qualified research expenses paid or incurred			
5	Wages for qualified services	5	_____
6	Cost of supplies	6	_____
7	Rental or lease costs of computers. See instructions	7	_____
8	Enter 65% (.65) of contract expenses	8	_____
9	Total qualified research expenses. Add line 5 through line 8	9	_____
10	Enter fixed-base percentage, but not more than 16%. See instructions	10	_____ %
11	Enter average annual gross receipts. See instructions	11	_____
12	Base amount. Multiply line 11 by the percentage on line 10	12	_____
13	Subtract line 12 from line 9.	13	_____
14	Multiply line 9 by 50% (.50). See instructions.	14	_____
15	Enter the smaller of line 13 or line 14.	15	_____
16	Multiply line 15 by 8% (.08)	16	_____
17	Tentative credit. Add line 4 and line 16. If you do not elect the reduced credit under IRC Section 280C(c), enter the result and see the instructions. If you do elect the reduced credit, multiply the result by 90.7% (.907) for individuals, partnerships, estates and trusts, and corporations, and by 98.5% (.985) for S corporations and enter the reduced amount	17	_____
18	Flow-through research credit(s) from passthrough entities. The credit may be limited. See instructions	18	_____
19	Current year research credit. Add line 17 and line 18	19	_____
20	Enter the amount of credit on line 19 that is from passive activities. If none of the amount on line 19 is from passive activities, enter -0-.	20	_____
21	Subtract line 20 from line 19	21	_____
22	Enter the allowable credit from passive activities. See instructions	22	_____
23	Non-passive activity credit carryover from prior years. See instructions	23	_____
24	Total available research credit. Add line 21 through line 23	24	_____

Caution: Your credit may be limited. See instructions for line 24.

Part II Computation of the Carryover. Do not complete this part if you must file Schedule P (100, 540, 540NR or 541).

25	Amount of research credit claimed on current year tax return. See line 24 instructions.	25	_____
26	Credit carryover to future years. Subtract line 25 from line 24.	26	_____

Instructions for Form FTB 3523

Research Credit

General Information

References in the form and instructions are to the Internal Revenue Code (IRC) as of January 1, 1993 and to the California Revenue and Taxation Code (R&TC).

The amendments made by the Revenue Reconciliation Act of 1993 to Section 41 of the Internal Revenue Code relating to the credit for increased research activities apply to taxable or income years beginning on or after January 1, 1994, for purposes of determining the California research credit.

In addition, California has not adopted the 1996 federal changes included in the Small Business Job Protection Act of 1996 relating to the research credit. Therefore, the references in these instructions are to the 1993 provisions of the IRC and the California research credit is determined in accordance with the prior federal law, with exceptions.

A What's New

Qualified Research for the Basic Research Payments.

Corporate taxpayers involved in specified biopharmaceutical research and biotech research and development activities that make payments to certain hospitals run by public universities and qualified cancer centers may claim the basic research credit on such payments for taxable or income years beginning on or after January 1, 1996. For further information, see the specific line instructions for form FTB 3523, line 1.

B Purpose of Form

Existing companies and "start-up" companies use form FTB 3523 to figure and claim a credit for increasing the research activities of a trade or business. The credit is 8% of the excess of qualified research expenses for the tax year over the base period research expenses. Additionally, for corporations only, 12% of the basic research payments will be allowed as a credit.

C Who Must File

An individual, estate, trust, organization or corporation claiming a credit for increasing research activities must attach this form to its California tax return. In addition, an S corporation, partnership, limited liability company, estate or trust that shares the credit among its shareholders, partners, members or beneficiaries must attach this form to its California tax return.

D Miscellaneous

The basic and qualified research must have been conducted within California.

If your business is conducted both within and outside of California, for purposes of determining the base amount, gross receipts are the receipts from the sale of property that is held primarily for sale to customers (in the ordinary course of your trade or business) and that is delivered or shipped to California.

A husband and wife may claim only one credit. If separate returns are filed, the credit may be taken by either or divided equally between them.

The credit cannot reduce the minimum tax (corporations, limited partnerships, limited liability partnerships, limited liability companies and S corporations), the alternative minimum tax (corporations, fiduciaries and individuals), the built-in gains tax (S corporations) or the excess net passive income tax (S corporations).

For S corporations, only 1/3 of the allowable credit as determined under the Bank and Corporation Tax Law may be claimed against the 1.5% tax, after applying the limitations relating to passive activity losses and credits. An S corporation is not allowed to carry over any portion of the 2/3 credit denied under the "one-third rule." In addition, 100% of the allowable

credit, as determined under the Personal Income Tax Law, may be passed through to the shareholders on a pro-rata basis.

Note: The credit may be limited. See R&TC Section 17052.12(h), IRC Section 41(g) and the instructions for line 18 for details.

Specific Line Instructions

Line 1 – Corporations (other than S corporations, personal holding companies and service organizations) may be eligible for a "basic research" credit if the 1996 payments in cash to a qualified university or scientific research organization (under a written contract) exceed a base period amount (based on your general university giving and certain other maintenance-or-effort levels for the three preceding years). To be eligible, the basic research must have been carried out within California.

Enter your 1996 payments on line 1. See IRC Section 41(e) and R&TC Section 23609(d) for details.

Biopharmaceutical and Biotech Research Activities

Corporations (for income years beginning on or after January 1, 1996) that are engaged in certain biopharmaceutical research and biotech research and development activities (as defined below) and that make payments to hospitals run by public universities (as defined below) or qualified cancer centers (as defined below) may be eligible to claim the "basic research" credit if they meet specific criteria.

The taxpayer's biopharmaceutical activities must satisfy both of the following:

- Meet at least one of the biopharmaceutical research activities described in Codes 2833 to 2836, inclusive or any research activities that are described in Codes 3826, 3829, or 3841 to 3845, inclusive of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition; and
- Be accomplished using organisms or materials derived from organisms, and their cellular, subcellular, or molecular components to provide pharmaceutical products for human or animal therapeutics and diagnostics. For biotechnology research and development, taxpayers must be involved in research and development activities regarding the application of recombinant DNA technology or pharmaceutical delivery systems.

If the taxpayer's activities meet the criteria mentioned in the paragraph above and such payments are made to a cancer center, the cancer center must be a "qualified cancer center" which is defined as meeting all of the following criteria:

- Is both tax-exempt under federal law (IRC Section 501(a)) and owned by a tax-exempt organization (described in IRC Section 501(c)(3)); and
- Has been designated a "specialized laboratory cancer center" and has received Clinical Cancer Research Center status from the National Cancer Institute.

If the taxpayer's activities meet the criteria mentioned above and such payments are made to a hospital owned by a public university, the hospital must be an organization described in IRC Section 170(b)(1)(A)(iii), and the public university that runs such hospital must be an institution of higher education as described in IRC Section 3304(f).

Line 2 – Enter the base amount as defined in IRC Section 41(e) and R&TC Section 23609. If you do business both within and outside of California, see General Information C. The amount on line 2 may not be more than the amount on line 1. This amount may be treated as 1996 contract research expenses on line 8 (subject to the 65% limitation).

Line 7 – See IRC Section 41(b)(2)(A) for rules on leased property if you receive payments from anyone for the rental or lease of substantially identical property.

Line 8 – Include 65% of any amount paid or incurred for qualified research performed on your behalf. For corporations only, include 65% of the portion of line 1 basic research payments that does not exceed the line 2 base period amount.

Line 10 – Compute the fixed-base percentage as follows:

Existing companies – The fixed-base percentage is the ratio that the aggregate qualified research expenses for at least three tax years from 1984 to 1988 bears to the aggregate gross receipts for such tax years. Round off the percentage to the nearest 1/100th of 1%.

Start-up companies – If a company has fewer than three tax years beginning after 1983 and before 1989 during which it had both gross receipts and qualified research expenses, its fixed-base is 3%, until taxable or income years beginning in 1994. There is a ten year phase-in period leading up to a credit based on five years of experience.

During the phase-in period, 3% continues to be used as the fixed-base percentage for a start-up company, but only during each of the company's first five taxable or income years beginning after 1993 for which it has a qualified research expense. For a start-up company's fixed-base percentage for its sixth through tenth years beginning after 1993, see IRC Section 41(c)(3)(B)(ii).

Note: The maximum percentage that can be entered on line 10 is 16%.

Line 11 – Enter the average annual gross receipts for the 4 tax years preceding the tax year for which the credit is being determined (called the credit year). You may be required to annualize gross receipts for any short tax year. See IRC Section 41(c)(1)(B) and Section 41(f)(4) for details.

For purposes of line 10 and line 11, reduce gross receipts for any tax year by returns and allowances made during the tax year. In the case of a business that is within and outside of California, include only the gross receipts from the sale of property held primarily for sale to customers in the ordinary course of your trade or business that is delivered or shipped to California, regardless of F.O.B. point or other conditions of sale.

Line 14 – The base amount cannot be less than 50% of the current year qualified research expenses. This rule applies both to existing and newly-organized businesses.

Line 17 – Unless you made an election to reduce the research credit, deductions under IRC Section 174 or any other deduction or credit provision for research expenses or basic research payments must be reduced by the amount of your current year's research credit.

Line 18 – Individuals, estates or trusts: Your share of research credit from a pass-through entity reported to you on Schedule K-1 (100S, 541, 565 or 568) may be limited due to IRC 41(g) and the related regulations. Specifically, the amount of credit entered on this line is limited to the amount of tax attributable to your interest in a proprietorship, partnership, S corporation, limited liability company, estate or trust generating the credit. Use the formula below to determine the credit limitation. If you have pass-through research credits from more than one business interest, figure the research credit limitation separately for each business interest by applying the formula below to each pass-through credit.

$$\text{Credit Limit} = \frac{\text{Taxable income attributable to your interest in the business from Schedule K-1}}{\text{Total taxable income for the year (Form 540, line 19; Form 540NR, line 19 or Form 541, line 19)}} \times \{\text{Net income tax}\}$$

For purposes of completing the formula above, **Net income tax** is regular tax (from Form 540, line 24; Form 540NR, line 27 or Form 541, line 20) plus alternative minimum tax (from Form 540, line 35; Form 540NR, line 44 or Form 541, line 25).

Note: The percentage representing taxable income attributable to your interest in the business to your total taxable income for the year cannot exceed 100%. If in the current taxable or income year you had no income attributable to a particular business interest, you cannot claim any research credit this year related to that business; although, the credit can be carried over. Likewise, any current year pass-through research credit that exceeds the IRC Section 41(g) limitation may be carried over. **However**, all pass-through credit carryovers will be subject to the IRC Section 41(g) limitation in each subsequent year.

Line 22 – If any part of the amount on line 19 is from a passive activity, you must complete form FTB 3801-CR, Passive Activity Credit Limitations, or form FTB 3802, Corporate Passive Activity Loss and Credit Limitations, to determine your allowable credit. Complete form FTB 3801-CR or form FTB 3802, (**using California amounts**), before completing the rest of this form.

Line 23 – Enter any research credit carryover from prior years **from non-passive activities only**. Any prior year credit carryover from passive activities should have been included in the computation of allowable credits from passive activities (form FTB 3801-CR) on line 22. **Individuals, estates or trusts:** If the non-passive research credit carryover was generated from a pass-through entity, you must apply the IRC Section 41(g) limitation to the credit carryover before entering the allowable carryover on line 23. See the instructions for line 18 above on how to compute the IRC Section 41(g) limitation.

Line 24 – The amount of this credit you may claim on your tax return may be limited. Refer to the credit instructions in your tax booklet to see if there are any limitations on the amount of credit you may claim. These instructions also explain how to claim this credit on your tax return. You must use credit code number **183** to claim this credit.

If available credit for the current year exceeds the tax, you may carry over any unused credit to succeeding years.