

Manufacturing



Tools for thought:

R&D Tax Credits-an underutilized small business benefit

If research and innovation are part of your business culture, you should consider securing R&D Credits.

The President is lobbying to both expand and extend the “research and experimentation tax credit” (the “R&D Credit”). A noble effort, but the irony is many qualified small businesses aren’t availing themselves of it. Manufacturers, contractors, architects, engineers, software developers and other innovators are leaving millions, perhaps more than a billion, dollars on the table annually. Similarly, use of the “research and development” deduction has been avoided due to its status as a tax preference under the alternative minimum tax, subject to elections beyond the scope of this piece.

The R&D Credit was a Reagan Administration initiative encouraging private sector innovation and keeping pace with foreign competitors. The Bush Administration expanded the R&D Credit’s application to a wider range of businesses, and the Obama Administration has proposed both making it permanent as well as expanding its application. The R&D Credit, although couched as a “temporary tax feature,” has been extended 14 times. It expired at 2011’s end.


Even with this underutilization, \$9 billion in R&D Credits were claimed in 2008 (the most recent tax year for which data is available). *Did your business participate?*

In 2008, agricultural companies claimed more than \$5 million, real estate companies claimed more than \$7 million, management companies claimed more than \$60 million, wholesale and retail companies claimed \$430 million, and transportation equipment manufacturers claimed more than \$1 billion.

Unfortunately, as a Bloomberg Government study concludes, large companies claim a disproportionate share R&D Credits because many small businesses either find it too difficult to file the IRS required information or are unaware they qualify for R&D Credits.

According to Bloomberg’s study, small businesses account for 40 percent of private-industry research but received only 23 percent of R&D Credits in recent years. Bloomberg’s study found a few common reasons for businesses not taking full advantage of R&D Credits:

- They do not know they qualify for a R&D Credit.
- The R&D Credit formula is too complex and the required documentation is too difficult to obtain.
- They are worried about making a long-term R&D investment when the R&D Credit could expire.



Tax credits usually mean more to profitable companies, but as R&D Credits can be claimed for all open tax years (generally meaning the current year and the past open tax years) and those credits carry forward for up to 20 years, R&D Credits may be valuable even to companies currently operating at a loss.

Defining 'R & D'

Time, money and other resources devoted to improving a product or process could result in a R&D Credit for your business. If you devoted resources are directed at:

- Research which is technological in nature.
- The activity and your devoted resources are directed at a new or improved product or process.
- The activity and your devoted resources are directed at the discovery of information that is currently unknown.
- The activity and your devoted resources must evaluate alternatives.

Hence, developing a lighter or more flexible tool, designing a unique electrical system for a new building, testing new materials, applying for a patent or streamlining an internal process can deliver an R&D Credit to your business.

R&D Credits cover employee wages directly contributing to R&D, supplies and software used in R&D activity, and contracted R&D services. There are two alternative measures of the R&D Credits:

- 20 percent of R&D expenses above a “base amount” (based on a fixed base percentage and the company’s average annual gross receipts of the preceding 4 taxable year), or
- 14 percent of R&D expenses above 50% of the company’s average R&D expenditures over its previous three years (aka the simple measurement).

Frequently, small businesses find it challenging to segregate normal business expenses from those that result in R&D Credits. R&D specialists can assist in that segregation process and often return R&D Credits far in excess of the specialist’s fees.

Proposed simplification to R& D Credits

The Obama Administration has proposed two revisions that (a) raises the simple R&D Credit measurement to 17 percent and (b) makes the R&D Credit permanent.

Regardless of the Obama Administration initiatives success, there are short-term savings and long-term implications which make current pursuit of R&D Credits for forward looking companies desirable.

To learn more about R&D Credits and how they may favorably impact your business, contact Stephen C. Smith, or your Holbrook & Manter representative before attempting to take full advantage of R&D Credits. We facilitate R&D Credits for growth-minded clients.

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