

# 2015 PATH ACT and Changes to the Research & Development Tax Credit

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# About Tax Group International

- ▶ **Specialty Tax Service Provider**
- ▶ **Founded 15 years ago by Big 4 Tax partners**
- ▶ **Support team of professionals experienced in all facets of the tax credit industry**
- ▶ **Studies are supported with detailed deliverable**
- ▶ **Initial assessment is at no cost to our clients**
- ▶ **All studies include audit defense at no additional cost**
  - ▶ **Fees are reduced on a prorated basis should the IRS disallow any portion of the benefit**
- ▶ **Offices in France, Canada and throughout the U.S.**

# Tax Group International: Service Lines

- ▶ **Research & Development Tax Credit:** Businesses in nearly every industry can benefit from federal and state research and development (R&D) tax credit programs.
- ▶ **DPAD (Domestic Production Activity Deduction):** Taxpayers may qualify for DPAD if they in whole or in significant part manufacture, produce, grow, construct, engineer, or conduct other activities within the United States.
- ▶ **IC-DISC/Export Incentives:** (Domestic Charge International Sales Corporation) Qualified producers or distributors that are either directly involved in exporting, or selling products to distributors or wholesalers who resell for use outside of the U.S. may benefit from an IC-DISC.
- ▶ **Cost Segregation:** Companies and individuals, who have constructed, purchased, expanded, or remodeled any kind of real estate may benefit from a cost segregation study.
- ▶ **Captive Insurance:** Businesses that are overpaying for third party insurance or with significant uninsured or underinsured risks may benefit from a captive insurance.
- ▶ **IRS Interest Review:** A review of IRS accounts, interest and processing may result in significant reduction or refund of interest and penalties as well as the correct application of tax payments and credits.
- ▶ **IRS Representation:** Different tax positions require different resources to optimize your defense. Having access to a multitude of experts can help to offset the risk associated with any given potential tax liability.

# The 2015 Path Act - Why Is It So Important

- ▶ There are 115 provisions of the PATH Act.
  - ▶ **The Research & Development Tax Credit** is the most expensive provision of the PATH Act.  
**Cost: \$113.2B**
  - ▶ The top 12 provisions are expected to cost **\$526.2 Billion.**
  - ▶ This package adds some much needed **permanency to the Code**, ensuring that we, as taxpayers, can finally act with some certainty.

# 2015 PATH Act Changes the Research & Development Tax Credit

- ▶ **The Research and Development credit is made permanent**
- ▶ Per the March 10, 2016 Houston Business Journal: **“The R&D credit is back and better than before!”** All companies should now take a hard look at the new and improved R&D tax credit.
- ▶ Since 1981, this credit has expired and been renewed 16 times, making it one of the most unstable parts of the tax code. Companies can now add the R&D tax credit to their **arsenal of tax planning activities** without worry of whether or not the credit would be expired.

# What is the Research & Development Tax Credit?

## ▶ Companies OFTEN believe they do not qualify:

- ▶ **It is not just for C-Corps**, but S-Corps, and LLCs can qualify as well, public and private
- ▶ The calculations can be very **complex**, but in the end, very rewarding
- ▶ The **new rules** and **regulations** outlined in the PATH Act have **made it easier** for all types of businesses to profit from the R&D Tax Credit
- ▶ In particular **start-ups** and other small businesses should take distinctive note of major changes specifically intended for their advantage

## Benefits:

- ▶ It is a **dollar for dollar** reduction in income tax liabilities
- ▶ Can be used to **reduce** estimated tax payments
- ▶ One year **carry back**, twenty year **carry forward**
- ▶ Available for all **open tax years**, three years Federal, four years many states

# We do not have Research & Development Activities

Most companies think they do not qualify because they are thinking of the **“Dictionary”** definition Research & Development, and not the **“Tax”** definition of Research & Development.

The credit does reward research taking place in laboratories, but it also reward **“research”** taking place **outside** of the laboratory as most businesses do not even have laboratories.

If a company has simply invested time, money, and resources toward the **advancement and improvement** of its **products and processes**, it may qualify.

**Per Steve Miller, Former Acting IRS Commissioner:  
“The R&D credit is one of the most overlooked  
opportunities afforded to U.S. businesses...”**

# PATH ACT Enhancements to the R&D Tax Credit: Start-Up Business

- ▶ Start-ups can now take advantage of the credit.
- ▶ Start ups are defined as businesses with gross receipts of less than \$5M / year and no gross receipts for any tax year preceding the five tax year period ending with the tax year.
  - ▶ If the first year of election is 2016 then the company must have had not gross receipts in a tax year preceding 2012.
  - ▶ 2012 - 2016 must have less than \$5 million in Gross Receipts.
  - ▶ 2011 prior must have zero Gross Receipts.
- ▶ The benefit is capped at \$250,000 against payroll taxes.

Many small businesses have payroll tax expenses but no income tax while they are in start-up mode which makes the new election to use R&D credit against payroll taxes an opportunity to get immediate benefit from the R&D credit!



# PATH ACT Enhancements to the R&D Tax Credit: Small Business

**Starting in 2016 the PATH Act effectively turns-off the AMT bar for “eligible small businesses!”**

Eligible small business is defined as having an average of **\$50 million or less in gross receipts the prior three years.**

- ▶ Cannot be a publicly traded company.
- ▶ 2016 credits will be first applied to reduce AMT.
- ▶ Carry forward tax credits prior to 2016 can be used on a go forward basis after AMT is reduced.
- ▶ The majority of small and mid-sized businesses are organized as pass-through entities and are taxed at the owner’s individual tax rate.
  - ▶ This leads to many owners being subject to the AMT barrier.
  - ▶ Even if a business had engaged in activities that would normally qualify for the R&D tax credit, that business would still effectively be barred from claiming the credit.

The removal of the AMT bar is expected to allow for a tenfold increase in the number of small businesses that can utilize the R&D tax credit.

# Texas R&D Tax Credit

Beginning with tax returns filed **after January 1st, 2014**

- ▶ Taxpayers in Texas can claim the R&D Tax Credit to offset a portion of their **franchise tax** or,
- ▶ Use it towards a **sales and use tax exemption** on the purchase or lease of depreciable tangible personal property used in qualified research in Texas.

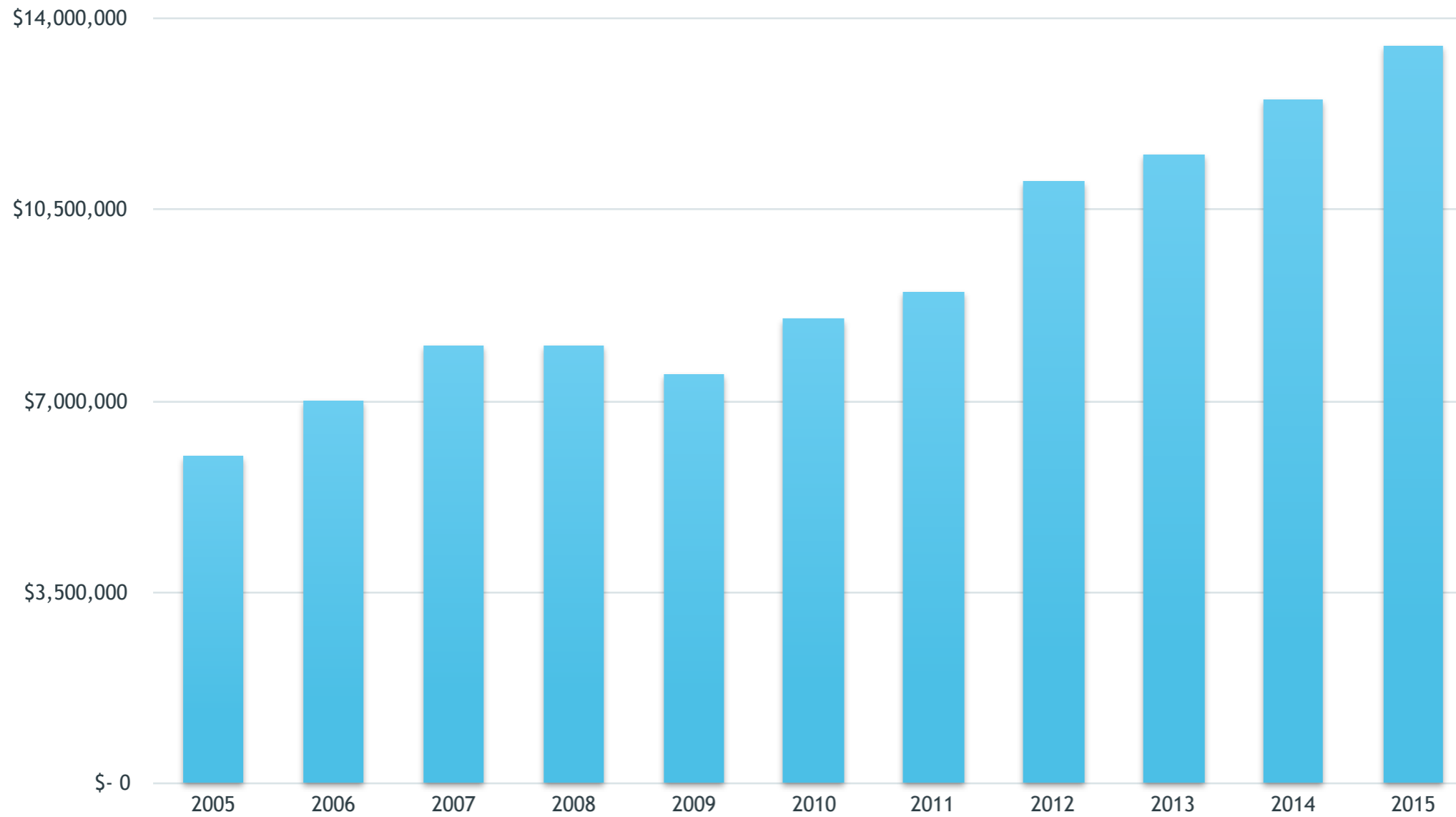
Some highlights of the Texas R&D Tax Credit include:

- ▶ Qualified Research Expenses (QREs) have the same meaning as in IRC § 41, except that such **expenses must be for research conducted within Texas.**
- ▶ The credit amount is 5% of the excess amount of qualified research expenses in the current period over the base amount (50% of the average of the previous three years).
- ▶ The allowable Franchise Tax Credit in any one period, including carry-forward amounts, can not exceed 50% of the franchise tax due for the period.
- ▶ Unused credits can be carried forward for up-to 20 years.
- ▶ The sales and use tax exemption will be effective for activities beginning after January 1st, 2014.



# Federal R&D Credits by Year

Research Credits by Year (in thousands)



# Qualifying Industries

- ▶ Aerospace & Defense
- ▶ Agriculture
- ▶ Apparel and Textiles
- ▶ Architecture
- ▶ Automotive
- ▶ **Brewing / Winemaking**
- ▶ Chemical
- ▶ Construction
  - ▶ Electrical Contracting
  - ▶ General Contracting
  - ▶ Mechanical Contracting
  - ▶ HVAC
- ▶ **Consumer Food & Beverage**
- ▶ Electronics
- ▶ **Engineering - All Disciplines**
  - ▶ Civil
  - ▶ Electrical
  - ▶ Environmental
  - ▶ Mechanical
  - ▶ Product
  - ▶ Structural
- ▶ Farming
- ▶ Furniture & Cabinet Manufacturers
- ▶ Job Shops
- ▶ Life Sciences
- ▶ **Manufacturing**
- ▶ Metals / Foundries
- ▶ **Oil & Gas**
- ▶ Pharmaceuticals
- ▶ Plastics
- ▶ Plastic Injection Molding
- ▶ Pulp & Paper
- ▶ Recycling
- ▶ **Software & Technology**
- ▶ Shipbuilding
- ▶ Steel
- ▶ Tool & Die
- ▶ Transportation
- ▶ Telecommunications
- ▶ Waste Management
- ▶ Numerous Others

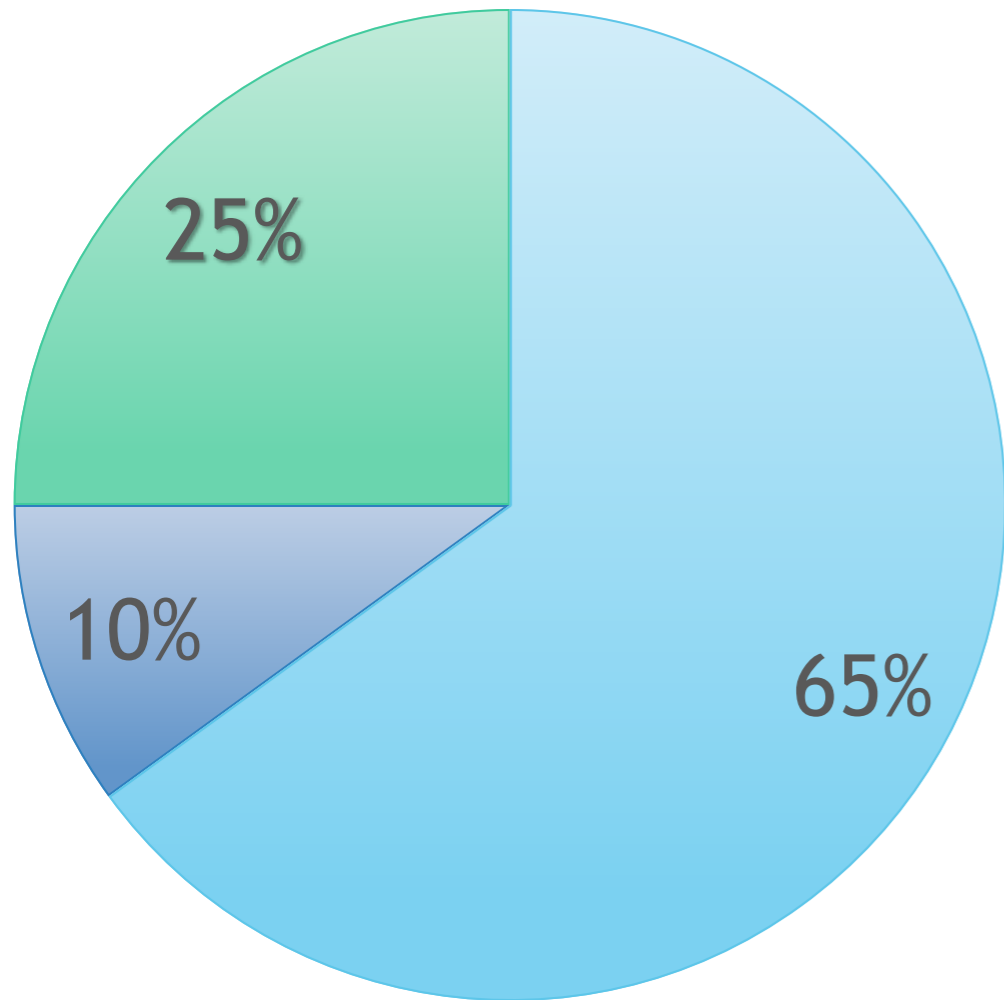
# Tax Group International Case Studies

Industry	Annual Revenue	Federal Credit
Software	\$10M	\$900,000
Defense	\$15M	\$600,000
Entertainment	\$100M	\$1,000,000
Consumer Food	\$50M	\$300,000
Nutritional Supplements	\$5M	\$130,000
Engineering	\$20M	\$120,000
Manufacturing	\$125M	\$1,050,000
IT	\$250M	\$3,000,000
Broadcasting	\$2.5B	\$2,500,000

# Who is Claiming the R&D Tax Credit?

Industry	Credit Amount 2015	Percentage
Manufacturing	\$8.3B	61%
Information	\$2.3B	16%
Professional, Scientific, Technical Services	\$1.4B	10%
Wholesale and retail trade	\$947.7M	7%
Finance and Insurance	\$288.3M	2%
Holding Companies	\$137.3M	1%
Mining	\$96.1M	1%
Utilities	\$41.2M	<1%
Other	\$205.6M	1.5%
Total	\$13.7B	

# Qualified Research Expenditures



## Wages-employees

- ▶ Largest component
- ▶ W2
- ▶ 80% or more = 100%

## Contract Research, non-employees

- ▶ 65% of contract research expenses

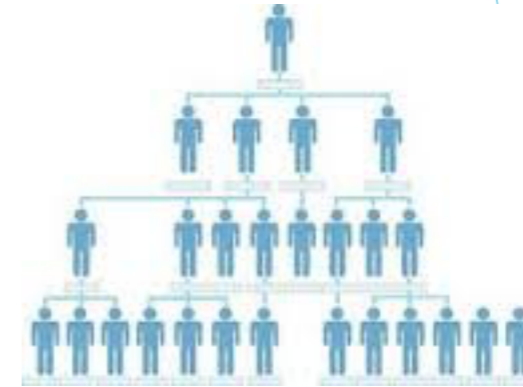
## Supplies

- ▶ Non-depreciable, tangible personal property
- ▶ Consumed or destroyed during research

# Required Materials

Source documents to provide a more detailed analysis, **if available**, is as follows:

- ▶ Current General Ledger
- ▶ Latest Available Tax Return
- ▶ Employee Roster with job description
- ▶ W2's or payroll report
- ▶ Project list, if applicable
- ▶ Organizational chart





# Qualifying Activities

- ▶ **Innovative product development** using computer-aided design tools
- ▶ **Development** of second generation or improved products
- ▶ **Tooling and equipment fixture design and development**
- ▶ **Designing innovative manufacturing equipment design**
- ▶ **Prototyping** and three-dimensional solid **modeling**
- ▶ **Failed projects due to technical uncertainties**
- ▶ **Testing** and stress analysis
- ▶ **Develop** new, improved or more reliable products, processes or formulas
- ▶ **Develop** computer generated models
- ▶ **Develop** or apply for **patents**
- ▶ Perform certification **testing**
- ▶ Conduct **testing** of new **concepts** and **technology**
- ▶ **Develop new technology**
- ▶ Attempt using **new materials**
- ▶ Perform environmental **testing**
- ▶ Add **new** equipment
- ▶ **Automate/streamline** production process or manufacturing process
- ▶ **Develop** software or hardware
- ▶ **Improve or build new** manufacturing facilities

# Why Are You NOT Claiming the R & D Tax Credit?

## Top Five Myths:

Many companies that have eligible activity erroneously disqualify themselves from claiming the R&D tax credit. **Self-censoring** remains the greatest issue with businesses overlooking the credit.

**Myth #1:** The R&D tax credit is only for companies that invent something revolutionary.

- ▶ The R&D tax credit is designed to encourage innovation. The regulations define research as activities “intended to **eliminate uncertainty**” based on information available to the taxpayer at the outset of the project. The R&D tax credit extends to activities companies perform on a daily basis as they try to **improve their business and production processes**.

**Myth #2:** The R&D tax credit is not available for companies that fail in their research.

- ▶ You do not have to be successful to claim the credit. The R&D tax credit is an **efforts-based credit**.

# Why Are You NOT Claiming the R & D Tax Credit?

**Myth #3:** The R&D tax credit won't help my company because my company is not profitable.

- ▶ The credit carries **forward 20 years and back one year**. Thus, it could be of immediate benefit if your company was profitable in the prior year and can be banked for use in future profitable years. Also, small start-up companies may now be able claim a credit against their payroll tax.

**Myth #4:** The R&D tax credit is not available to my company because our research is funded by the government.

- ▶ The R&D tax credit requires both technical uncertainty and financial risk. If a contract requires the taxpayer to succeed or return funds, or to incur additional costs, the taxpayer is at **financial risk** and thus eligible for the R&D tax credit.

**Myth #5:** We will get audited.

- ▶ Filing for the R&D tax credit, both on timely and amended filings, is no longer a "TIER ONE ISSUE". It has as much of a chance of being audited as any other item on your tax return. **The IRS audit rate is 7% for US corporations.**



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