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R&D Tax Credit -- Still The One For Small And Medium Business Owners

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Taxes - I write about tax policy and how it affects business.

The research and development (R&D) tax credit is finally in a good place – with Congress making the federal credit permanent, and ultimately expanding it so that small and medium businesses can now easily reduce their tax bill.

Over time, Congress began to realize an imbalance of companies who were taking advantage of the credit. Primarily it was the country's corporate giants – more specifically large-scale manufacturers – who were utilizing the government incentive. This left out the very companies at the heart of our country's economic prowess: the small and medium sized businesses of America.

Congress decided to take action and passed the PATH Act in 2015 to widen the field and making the credit part of the U.S. tax code (and at the same time make the credit permanent). In doing so, Congress eliminated probably the biggest hurdle for small and medium businesses wanting to claim the credit — the Alternative Minimum Tax bar – allowing businesses with \$50 million or less in gross receipts to take advantage of the incentive.

Small and medium sized businesses are now claiming the credit more and more often, enabling them to put funds back into their business to improve products or processes that they otherwise would not have, leading to a more competitive landscape – and ultimately a stronger American economy.

However, despite the R&D tax credit now being in existence for nearly 40 years – and providing roughly \$10 billion a year in tax savings to businesses – what we see working with companies and CPAs to qualify for the R&D tax credit is that the problem remains that small and medium business owners too often self-censor when it comes to applying for the credit.

These businesses are still failing to take advantage of the credit – while big businesses such as Amazon continue to use the credit to its full potential, greatly reducing, or wholly eliminating, their tax bill.

Basic Questions for Business Owners

For a business owner, trying to get into the weeds of the R&D credit can be a grind. For a business owner it may be simpler to think about a few basic questions as a threshold matter, and then decide whether it makes sense to talk further to a tax professional familiar with the credit.

First, does your company make something? Some broadly defined examples include: software, manufacturing, architecture, engineering, food, food processing and construction companies – here’s a bigger list of possible good candidates for the credit. Not so good – lawyers, accountants etc. But even fields that you wouldn’t think of making something – such as financial services, warehouse services – should think hard about software (internal use as well as customer-facing) that might qualify.

If you do make something – are you making the exact same product the exact same way? It would be pretty rare for a growing, engaged company to be making the exact same widget the exact same way over the years. And remember, the R&D tax credit potentially covers not only 1.0 of a product, but also the improvements – 2.0; 2.1 – including the process of making a product (cleaner, greener, quicker, cheaper, automation, etc.).

Don’t Self-Censor

Here are the top reasons I hear from business owners for why they think they do not qualify for the R&D tax credit (and my response):

My company was paid for the work.

The fact that a company is paid for the work (think of a subcontractor or government contractor) is not a roadblock – the critical point being if the company has risk for its work (example, if your work is rejected do you still get paid?). The bottom line is we have thousands of subcontractors and government contractors who qualify for the R&D tax credit – it is an “it depends” question, known as a funding analysis, but not a showstopper.

My company did not get a patent.

While a patent is nice – it is not required. Again, recall that this is about applied research as well as basic. There is not a discovery test – no eureka moment. The research in question has to be new to you.

The project/research failed.

Business owners know that there is no end of false starts and dead ends – and the Internal Revenue Service, to its credit, recognizes that as well. While it is disappointing that a project didn’t pan out – it still may be a good candidate for the R&D tax credit.

We do not do basic research.

Business owners often have visions of beakers and lab coats to qualify for the R&D tax credit – and yes, that is certainly a strong possibility for the credit – but not a requirement. Again, applied research is equally in harness to potentially qualify for the credit.

While all of this is not a walk in the park, the possible tax savings at the federal and state level are well worth the effort. The Amazons and Apples of the world have a platoon of tax lawyers and accountants to help them qualify for this valuable government incentive. Owners of small and medium businesses need to recognize that if they want similar, good results and real tax savings like the big boys – they need to call in the cavalry.

With recent tax reform, the R&D tax credit remains one of the few ways for many businesses to significantly cut their tax bill.



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