

Nine Myths About the R&D Tax Credit

By Steve Powers, President, Intrepid Advisors

I'm introduced to owners and managers of manufacturing and technology-based companies virtually every day, and even after 25+ years in the business, I still find it interesting that many business leaders are unaware or unfamiliar with the research tax credit and the financial benefits it can provide their companies. In particular, federal and state R&D tax credits allow companies conducting qualified research to offset their corporate taxes by as much as 20% of the costs incurred in their development efforts. Surprisingly, fewer than 5% of America's middle market manufacturers and technology companies claim the R&D credit, leaving substantial tax dollars on the table that otherwise could be reinvested in their businesses. I've observed that many companies are not claiming the R&D tax credit because of one or more of the following myths:

Myth #1: Only companies involved in scientific research are eligible for the R&D tax credit.

This is perhaps the most common area of confusion. The R&D tax credit was instituted by Congress to encourage innovation, spurring job growth and economic activity. As such, it is available to companies in all industries that attempt to create new or improved products or processes where the research or development activity involves the "elimination of technical uncertainty".

Myth #2: The R&D tax credit is only for big companies

Companies of all sizes may claim the R&D tax credit. There are no company size or revenue requirements. The credit is only based entirely on the type of development activities and expenditures. Of all the U.S. manufacturers and technology companies in the know leveraging R&D tax credits, total claims amount to about \$15 billion a year; approximately half being in the middle market or small business sectors.

Myth #3: Claiming the R&D tax credit increases the risk of an IRS or state audit.

This is untrue. Claiming an R&D tax credit does not increase the risk of a federal or state audit.

Myth #4: A complex time tracking system is necessary to capture R&D hours.

The IRS allows alternative methods for determining the time spent by employees on R&D activities.

Myth #5: The research credit can only be claimed on a current tax year return.

The R&D tax credit can be claimed on amended federal returns filed within three years of the original filing date. Regulations concerning the filing of amended state returns varies from state to state, though most allow filing amended returns within three years of the due date.

Myth #6: The R&D tax credit cannot be claimed for failed development efforts.

Contrary to this commonly misunderstood notion, expenses associated with unsuccessful development projects also qualify for the R&D credit.

Myth #7: The R&D tax credit cannot offset state taxes.

Currently, nearly 40 states have an R&D tax credit program in which to promote economic growth and create jobs. Most state eligibility requirements mimic federal eligibility requirements, while some states allow the credits to be exchanged for cash. Note that the credit calculation methods and filing procedures vary widely from state to state and often differ significantly from the federal tax credit.

Myth #8: The R&D tax credit can only be used to offset income tax.

Not so. A small startup business with less than \$5 million in yearly revenue can utilize up to \$250,000 of their R&D tax credits to offset the employer's portion of payroll taxes for the first five years in which they have revenue. This is especially important for companies that do not have income and that are not subject to paying income tax.

Myth #9: The calculation is complex.

This is TRUE. There are two general methods for computing the R&D tax credit, the Regular Credit (RC) Method and the Alternative Simplified Credit (ASC) Method. The taxpayer is permitted to elect either of the two methods when preparing a timely filed return, but since each method has distinct advantages and disadvantages, it is important to understand the two computation methodologies. In addition, documentation is required to substantiate the qualifying research activities.

An experienced R&D tax firm such as Intrepid Advisors, with a team of financial specialists and experienced engineers, can help determine and document your qualifying research activities and assist with the complicated calculations. As a result, companies are able to maximize their tax credits while saving valuable time and resources.

Intrepid Advisors' mission is to help our clients receive maximum R&D tax credit benefits while providing critical supporting documentation for a reasonable fee. We also provide no-cost assessments to establish whether our client's research and development efforts meet the qualifying research activities criteria.