



CHORTEK & GOTTSCHALK, LLP
CPAs AND BUSINESS ADVISORS

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R&D Tax Credit

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The Opportunity

- If your company has invested time, money, and resources to the advancement and improvement of your company's products or processes, then you likely have qualifying research under the Federal R&D Tax Credit/Incentive Program.
- **Are you taking advantage of all of the research and development credits available?**
- The R&D Tax Credit Opportunity:
 - ◆ A hidden and immediate source of cash for many companies;
 - ◆ A significant reduction to current and future years federal and state tax liabilities;
 - ◆ Over \$7.5 BILLION in federal R&D tax credit benefits are given out annually;
 - ◆ Approximately 80% of the \$7.5 BILLION goes to a few of the nation's largest companies;
 - ◆ Every successful company is potentially eligible for an R&D Tax credit of some amount – many companies are unaware that their day-to-day operations can qualify for the R&D Credit;
 - ◆ The 20% research tax credit is not a deduction. It is an actual dollar-for-dollar credit against taxes owed or taxes paid. Additionally, the taxpayer may be able to expense all such costs in the year incurred;

The Opportunity

- ◆ A business can take the credit for all open tax years – generally the last three or four years plus the current year;
- ◆ Additional years may be available if the taxpayer is in a net operating loss or alternative minimum tax position;
- ◆ Tax credits may carry forward twenty (20) years;
- ◆ Recent tax laws are taxpayer friendly and bring additional benefits;
- ◆ In addition to the Federal R&D Tax Credit, there are additional State tax credits.

What Qualifies as R&D?

- Many taxpayers tend to regard “R&D” as an activity associated solely with high-tech, biotech and pharmaceutical type companies.
- We have found many of our clients tend to regard their own efforts to make new, lighter, stronger, cheaper, more reliable products, or to make more precise, more economical and more versatile processes as “just doing my job,” when in fact they have been performing R&D qualifying activities all along.
- If your Company is involved in any of the following activities, you may be able to claim the R&D tax credit:
 - ◆ **Manufacture products;**
 - ◆ **Develop new, improved, or more reliable products / processes / formulas;**
 - ◆ **Develop prototypes or models (including computer generated models);**
 - ◆ **Design tools, jigs, molds, and dies;**
 - ◆ **Develop or apply for patents;**
 - ◆ **Perform certification testing;**
 - ◆ **Conduct testing of new concepts and technology;**
 - ◆ **Development of new technology;**

What Qualifies as R&D?

- ◆ **Attempt the use of new materials;**
 - ◆ **Add new equipment;**
 - ◆ **Perform environmental testing;**
 - ◆ **Develop or improve production / manufacturing processes;**
 - ◆ **Develop, implement or upgrade systems and / or software;**
 - ◆ **Develop production control software;**
 - ◆ **Improve or build new manufacturing facilities;**
 - ◆ **Automate / streamline internal processes; and**
 - ◆ **Expend resources on outside consultants / contractors to do any of the above stated activities.**
- In addition, many taxpayers miss out on qualified R&D expenditures in areas such as manufacturing, engineering, quality assurances, marketing, purchasing and information technology.

Eligible Costs

■ Wages

- ◆ Form W-2 wages
- ◆ Excludes 401(k), benefits, & overhead costs

■ Supplies

- ◆ Items used or consumed in the qualified activity
- ◆ Costs to fabricate prototypes

■ 65% of *Contract Research*

- ◆ Where the taxpayer pays someone other than an employee to perform qualified research
- ◆ Fees paid to consultants or engineering firms
- ◆ The Taxpayer must bear the economic risk (funding issue)

Calculating the Fixed-Base Percentage

<i>Year</i>	<i>Qualified Research Expenses</i>	<i>Gross Receipts</i>
1984	\$700,000	\$30,000,000
1985	800,000	20,000,000
1986	900,000	20,000,000
1987	1,000,000	50,000,000
1988	<u>1,100,000</u>	<u>30,000,000</u>
Total	<u>\$4,500,000</u>	<u>\$150,000,000</u>

Fixed-Base Percentage = $\$4,500,000 \div \$150,000,000$ or 3%

Calculating the 2007 Qualified Expenses

	<i>Total Cost Incurred</i>	<i>Qualified Research Expenses</i>
Wages Subject to Withholding	\$11,000,000	\$11,000,000
Fringe Benefits not Subject to Withholding	1,000,000	0
Supplies	2,500,000	2,500,000
Depreciation	3,000,000	0
Overhead	12,500,000	0
Contract Research	<u>10,000,000</u>	<u>6,500,000*</u>
Total	<u>\$40,000,000</u>	<u>\$20,000,000</u>

*65% of contract research qualifies

Calculating the 2007 R&D Credit

Qualified Research Expenses	\$20,000,000
Less: Base Amount	<u>15,000,000</u>
Incremental R&D Expenses	5,000,000*
Effective R&D Credit %	<u>x 13%</u>
Federal R&D Credit	<u><u>\$650,000</u></u>

*May not exceed 50% of qualified research expenses.

*Note: State R&D credit calculations generally parallel federal computation with certain modifications.
States usually allow credit only for R&D performed in-state.*