

THE BOTTOM LINE



*Samuel C. DiSalvo, CPA, J.D.
Director, Freed Maxick*



*Don L. Warrant, CPA
Director, Freed Maxick*

R&D Tax Credits –New

Opportunities for Manufacturers

Changes to federal tax rules in 2015 potentially expanded the activities that qualify for the research and development (R&D) tax credit and the taxes the credit can be used to offset.

Manufacturers may now be eligible for expanded R&D tax credit benefits in future and prior years.

More benefit from the credit means more cash available to manufacturers.

2015 Changes:

- **The Credit Is Now Permanent**
- **Certain Small Businesses Can Use the Credit to Offset Alternative Minimum Tax.** Starting in 2016, eligible small businesses (ESB) can claim the R&D credit against an alternative minimum tax liability. Generally, an ESB includes partnerships, sole proprietorships, and privately held corporations whose average annual gross receipts for a 3 tax-year period does not exceed \$50 million.
- **Certain Start-up Businesses Can Use the Credit to Offset FICA Tax.** Beginning in 2016, businesses with less than \$5 million in gross receipts in the current tax year and no gross receipts before the 5 tax-year period ending with the current tax year can use the credit to offset a limited amount of their FICA tax obligation. Generally, the offset is limited to the lesser of \$250,000, the current year credit, or, for regular corporations, the amount of the credit carryforward.
- **IRS Noted Increasing Importance of Business Software.** The government explicitly limited the application of the internal use software (IUS) rules to general and administrative (backroom) functions. IUS activities have a much higher threshold for eligibility and by limiting their application, software activities eligible for the credit are expanded.
- **Website Design Costs.** The IRS acknowledged that certain software development costs for websites to interface with third parties may never have been subject to the much more narrow IUS rules. Therefore, taxpayers may have an opportunity to claim more credit going forward and in prior open years.

R&D Tax Credits for Manufacturers – New York State Opportunities

New York provides the following tax credits for research and development activities:

1. Investment tax credit for research and development property;
2. QETC capital tax credit; and
3. QETC employment credit

New York manufacturers can claim an investment tax credit on depreciable property used predominately in research and development activities. An enhanced 9% credit rate instead of the regular 4% or 5% credit rate can be used. A new business may elect to claim a refund of excess credits.

In addition, qualified capital investments by non-owners in a manufacturer that is a “Qualified Emerging Technology Company” (QETC) can qualify for either a 10% or 20% New York State income tax credit. Certain limitations apply on the amount of the credit that may be claimed each year, however excess credits carry forward without limitation. Taxpayers who claim this credit should hold their investment for a sixty month period to avoid recapture.

Finally, manufacturers who are QETCs may claim an employment credit for up to three consecutive tax years. The tax credit is \$1,000 times the number of new full-time jobs created over a base period. Certain limitations apply; however, any excess credit is either refunded or applied as a tax payment to the following year.

Examples of research and development activities:

- Optimize or improve manufacturing processes or products.
- Certain use of computer-aided design (CAD) tools.
- Design and/or create tooling and fixtures for certain jobs.
- Design and/or create custom equipment or machinery.
- Develop specialized, proprietary computer software for a manufacturing process or product.
- Develop state of the art software to help you run your business more effectively or to compete more effectively or efficiently on the Internet.

To minimize or lower their tax burden, manufacturers conducting research activities should review their eligibility for federal and state level R&D credits. It is not uncommon for manufacturers to miss R&D tax credit opportunities.

Samuel C. DiSalvo is a Director with Freed Maxick's Tax Practice. Prior to joining the Firm, Sam spent over 25 years in the accounting profession with both Big Four firms and private industry. During this time, he gained significant experience with mergers and acquisitions, tax credits, and financial statement tax accounting. As part of his overall experience, Sam spent two years in the Washington D.C. national tax practice of a Big Four firm advising clients on tax developments in legislation, regulations, and policy.

Don L. Warrant is a Director in Freed Maxick's Tax practice and leads the Firm's tax credits and incentives practice where he provides consultation on accessing the various tax credits and incentives for businesses starting up or expanding operations. In addition, he provides assistance to the various Economic Development agencies across New York in their business attraction and expansion efforts.