

The Apparel Industry Benefits From R&D Tax Credits

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June/July 2010



In a challenging market known for its rapid changes, apparel companies need to seize every money-saving opportunity available. One of the most effective ways to generate savings these days is by

looking closely at what you pay in taxes. Unfortunately, it appears that many companies in the apparel industry are still leaving tax savings on the cutting room floor.

For example, outside of the aerospace, pharmaceutical, and other innovation-driven industries, many businesses are unaware of the research and development (R&D) tax credits offered by both federal and state governments. As an Associate Director at alliantgroup, I have worked with many companies in the apparel industry that have elected to take the R&D credit. In the course of the studies we perform to document this credit, we have identified numerous qualifying activities that are regularly conducted in the design and development of apparel products.

How Does This Apply to Apparel Companies?

In spite of what many people still believe, applicable tax laws and regulations do not require a business to discover something so innovative that it advances the field as a whole. Current statutes require only that a product or process be new or an improvement for the individual taxpayer. As defined in the tax code, R&D activities must meet four main requirements to be eligible for tax credits: 1) business component development or improvement; 2) elimination of uncertainty; 3) process of experimentation; and 4) technological in nature.

In the apparel industry, R&D activities are found in the design and development of new garments, shoes, accessories, textiles/fabrics, dye formulations, chemical and topical treatments, and weaving techniques. Apparel companies may have qualifying activities in all stages of development, from initiating the structural designs of the gar-

ments to the testing of the textiles, as well as manufacturing process improvements. For example, one apparel company we worked with generates annual sales of \$35-\$45 million designing and developing ladies' wear and has received more than \$300,000 in total R&D credits in the last four years. The company's personnel included designers, technicians, pattern makers, and sample makers who participated in qualifying activities such as formulating new leather and dye treatments and improving weaving techniques for a knitwear line. More specifically, extensive lab work was required on colorfastness and tensile strength testing in order to ensure that the quality of new products met the company's standards. The colorfastness testing led to the iterative evaluation of several dye formulations before a successful formulation was achieved. Additionally, the tensile strength analysis resulted in improvements to the weaving techniques that enhanced the quality and durability of the company's garments.

In another example, a large apparel company obtained more than \$800,000 in R&D credits. This client specializes in product planning, apparel design, and screen printing for the retail clothing industry. The company's facility includes in-house laboratory testing capabilities for quality assurance of prototypes. In the course of developing their product lines, the company ensured standards such as color permanence, appearance retention, tensile strength, dimensional stability, and shade control were met. Moreover, one of the company's major projects involved the design and development of a high-performance "technical" fabric. Due to the amount of internal resources allocated to these and other projects, the R&D credit was an enormous benefit to the company and allowed them to parlay the additional funds into new process equipment as well as an increase in hiring in the subsequent year.

Do You Qualify? If your apparel company has invested time and money in the improvement of designs and processes, then you may qualify for significant tax

savings. Further, if your company's personnel designs garments, textiles, handbags, or shoes, or develops processes for the design or manufacture of products, you may qualify for these savings.

Claiming the Credit: While CPA firms may well understand all the relevant tax law and regulations, few have the in-house apparel industry expertise to properly qualify and quantify the credit. Conversely, while apparel companies know their own business better than anyone, they don't have the tax expertise to know how to successfully claim the credit. Not only are laws and regulations involved, but also case law from tax court and other venues. For these reasons, outside firms, such as alliantgroup, with extensive expertise and experience in both tax law and the apparel industry, are generally called in either by the design firm or their CPA.

With the current economy, it is critical for businesses to seek all available tax credits and incentives, and with more than 7,000 federal and state tax credits and incentives available, it doesn't make sense to leave the cash lying on the cutting room floor.

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