

Making use of R&D tax credit

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Companies in the American plastics industry have seen many changes over the last few years. The needs of the world's emerging markets, plus intense competition from abroad, have forced companies to adapt, change focus and improve. What that translates into is extensive research and development toward making new and improved products, as well as improving processes. These efforts often qualify for federal and state R&D tax credits, helping companies recapture a significant portion of their costs.

Unfortunately, while the largest companies have always used this powerful tax incentive, many small and midsize companies are completely unaware that they would qualify. In fact, the R&D tax credit is a powerful incentive for activities that nearly every company in the plastics industry is performing, such as improving efficiency, reducing raw material cost, minimizing waste, designing and/or improving tools and equipment, and automating processes.

Understanding why such a range of activities qualify for the credit requires abandoning the traditional notion of R&D, which has been defined as developing products that are new to the company and the industry. Congress established a much broader definition to encourage companies to improve, and thus compete more effectively in the global marketplace and keep jobs in this country. R&D, for the purpose of this tax credit, is defined as developing new or improved business components, including products, processes, formulas, techniques, inventions and software. Companies can realize significant tax savings by capturing expenses incurred during these qualified projects and activities. These expenses can include wages, supplies and contractor costs.

Unfortunately, the traditional definition of R&D often causes companies to identify only a certain phase of the product development life cycle and the related costs in that specific phase for the credit. Further, in most cases, companies focus exclusively on activities taking place in their R&D or product-development departments as the only

source of qualified R&D projects. By limiting their view, they fail to receive the full benefit of the credit that they deserve. Further, new court cases and guidance on identifying and capturing these expenses for the credit have made it an evolving process.

Even though the R&D credit has existed since 1981, it is only in the last few years that changes to the documentation and qualification requirements have allowed this credit to be fully utilized by a company outside of the Fortune 1,000.

In 2009 alone, there were five major R&D tax credit court cases that provided additional guidance for qualification and documentation. One case involving TG Missouri Corp., a Perryville, Mo., automotive supplier, had broad implications for companies in the plastics industry. Specifically, the court ruled that a company could capture supply expenses incurred for the development of tooling and dies that were sold to the client.

Few certified public accountants have on staff the types of experts required to capture the full benefit of federal and state R&D tax credits to which many companies are entitled. Qualifying phases, projects, and R&D expenses that sometimes are overlooked include:

1. Initial phases of product development. Individuals working on developing product and functional specifications before knowledge transfer to the product development department.
2. Post-product development work. This includes expenses incurred during a scale-up/mass-production phase to develop processes to manufacture products to specified quality and prices.
3. Improved process development. Products a company has been manufacturing for years but improves to lower costs or improve quality.
4. Expenses supporting R&D projects. These expenses can include quality-control technicians, operators and outside testing labs

assisting in product and process development.

5. Supplies outside the product development department. These costs can include materials consumed in the scale-up phase and utilized for testing the quality of products developed in the scale-up phase.

Few companies have sophisticated job-costing or time-tracking systems. Further, even those companies with such costing systems rarely track qualified expenses for every phase of R&D. Their systems normally only detail product development and pilot-scale work and do not account for every qualified phase and expense. In the absence of those detailed systems, the task falls to an outside expert to identify and review all available documentation, which can include e-mails, notes, lab notebooks, testing reports and design drawings, just to name a few. By conducting interviews, reviewing project documentation and using forensic accounting, an expert is able to identify and document qualified projects and expenses. Further, this review of documentation enables a nexus to be established between qualified expenses and qualified projects, thus strengthening a company's claim to the tax savings the credit provides.

Too many companies operating in the industry are failing to take advantage (or full advantage) of a tax incentive that Congress and many state legislatures have put in place to help them compete and to help keep jobs in the U.S. The reason is often-outdated notions of what the R&D tax credit is and who is eligible. In this economy, it makes no sense for companies to leave money on the table that they can use to boost their bottom line and strengthen their businesses.

Companies not already doing so should talk to their financial advisers about this to find out if they are eligible and making full use of this important tax-saving incentive.

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