

# AUSTIN BUSINESS JOURNAL

## Changes to R&D Tax Credit means big savings for startups

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JANUARY 22, 2016

Already, 2016 is shaping up to be a banner year for startups – and believe it or not, CEOs and investors of innovative software and technology companies have Congress to thank.

Last month, as part of the bipartisan tax deal reached by Congress and signed into law by the president, the federal Research and Development Tax Credit was made permanent after years of last-minute, deadline-driven extensions.

Providing companies an estimated \$10 billion a year in annual tax savings, the R&D Tax Credit remains the largest such credit available to U.S. businesses. Due to Herculean congressional efforts, eligible companies can now move forward and be certain of the credit's future when considering their investments.

Not only was the credit made permanent for the first time in its 34-year history, but starting this year, it will be greatly expanded to benefit companies that were effectively barred from eligibility in the past. In particular, startups and other small businesses should take special note of major changes specifically designed for their benefit.

### **Startup provision**

For years, one of the real oddities of the R&D Tax Credit was that many innovative companies were unable to claim the credit as they were just opening their doors. As the majority of startups do not immediately turn a profit and thus pay no federal income taxes, that meant some of the nation's most cutting-edge companies were essentially barred from a credit designed to reward business ingenuity – clearly, an obvious disconnect from the intent of the credit to its real-world application.

An important amendment – the startup provision – changes all of that. Now startups (defined as businesses with gross receipts of less than \$5 million a year) can take the credit, capped at \$250,000 against their 2017 payroll taxes.

For startup owners, I don't need to tell you how impactful that amount of additional cash can be in ensuring the future of your business – but for simplicity's sake, let's take a real-world example. One software development company whose R&D activities alone would have qualified them for around \$100,000 in federal credits was unfortunately barred from their projected federal tax savings, largely a result of the company simply not being around long enough to generate profits for taxable income.

However, under the new provision, this same company with an annual payroll of \$1.75 million – that also pays \$108,500 in payroll taxes – would be able to use the credit to reduce their payroll taxes down to \$8,500. The net gain – \$100,000 in added tax savings – could be reinvested in any way the business owner deems fit.

### **AMT turnoff**

In addition to the direct startup provision, starting in 2016 small businesses (defined as businesses with less than \$50 million in gross receipts) will now permanently be able to claim the R&D credit against their alternative minimum tax, or AMT, thereby removing the single greatest barrier that prevented companies from taking advantage of the credit in the past.

Combined together, these two changes will mean more than \$2 billion in added tax savings for both startups and small business owners over the next few years. The removal of the AMT barrier is estimated to allow for a 10-fold increase in the number of small businesses that can utilize the R&D Tax Credit.

### **Measuring the impact**

Quite frankly, this is probably the biggest news on taxes for innovative startups in years. Its impact will be felt throughout a variety of industries. Due to these new provisions, startups and small businesses from a host of different technology and science-based sectors – from software, oil and gas and manufacturing, to mining, architecture, engineering, construction, plastics, chemicals and agriculture – will now have access to these valuable tax savings and have another means to grow and reinvest in their businesses and U.S.-based employees.

If your company is in any of the above fields and you are looking to hire new employees in the U.S., purchase new equipment or just expand your business in general, it may be time for you to explore the R&D Tax Credit.

Eligibility for the credit is more straightforward than commonly understood, as the credit's definition of "R&D" is much more expansive than just research taking place in a lab. Simply put, applied science counts as well, and the steps taken to make an existing product or process faster, cheaper, greener or more efficient – including nearly all software and technology development done in the U.S. – may mean you can qualify.

Unless your company has been making the exact same product the exact same way for the past five years, it might be time to explore the credit. Thanks to the good work put in by Congress, more businesses can reap the credit's tax benefits for the first time.



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