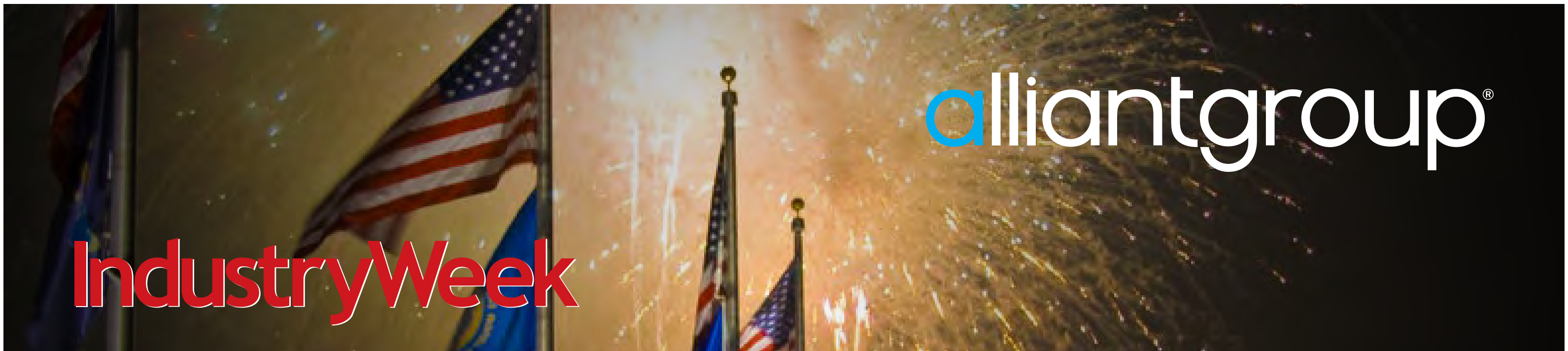

THE NEW AND IMPROVED R&D TAX CREDIT: THE TAX DEAL MANUFACTURERS WILL BE CELEBRATING FOR YEARS TO COME

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by Michael Siegel, *alliantgroup Managing Director*

Last month, a lot of coverage was given to the $600 billion plus tax deal passed by Congress and signed into law by the president. However, there is one specific provision of that deal that will have manufacturers celebrating a major long-term windfall starting in 2016 and in the years ahead.

Specifically, I am referring to the changes made to the Research and Development (R&D) Tax Credit, which through major bipartisan efforts was not only made permanent, but includes a key modification that will greatly expand the number of companies that can claim what is still (at $10 billion in annual tax savings) the largest tax credit out there for U.S. businesses.

To ensure manufacturers are aware of these changes and how they are set to greatly benefit their industry, let's begin with a short review of the credit.

THE R&D TAX CREDIT: THE BASICS

Whenever I introduce the R&D Tax Credit to a manufacturer, I find it helpful to clear up a key misconception.

Understandably, in my experience, whenever the average business owner hears the term "research and development," they have the habit of relating R&D only to the kind of work taking place in a science or research lab. However, with respect to the world of tax, what manufacturers must know is that the government's definition of R&D is much more expansive and covers qualifying projects and activities from a number of different industries. Put simply, the R&D Tax Credit is as much about the applied sciences as it is laboratory research, with eligibility tied to improving existing products or processes—in other words, the steps taken to make a product or process better, faster, cheaper, cleaner or more efficient.

To take a real-world example, a tool and die manufacturer working within the automotive industry received $390,535 in federal tax credits for three years' worth of eligible projects. The company was able to qualify for the credit due to a host of qualifying activities, but for simplicity's sake, let's dive into one work project in particular to understand the intent of the credit—the development of a die for a military-grade battery case cover. The cover required the use of 5/16-inch-thick steel, which contained rigid qualities that created difficulties in the molding process. To overcome this challenge, the company experimented with various die faces to strike the material and eventually developed a new procedure for creating the cover by integrating striking, blasting and design updates during the tooling process.

Using scientific principles to solve production issues or to improve upon already existing products or processes—those are major ways that businesses can qualify for the R&D Tax Credit. Generally, work that requires multiple test runs or other forms of technical problem solving (be it from behind a computer or on the shop floor) tends to qualify, resulting in manufacturers often being ideal candidates for the credit. Case in point, according to statistics from the IRS for the last tax year on record, manufacturing companies comprised the largest amount of R&D Tax Credit claims at 39.2 percent.

And now, due to new legislation and a key modification to the credit, that number is set to expand in the coming years.

PERMANENCY: THE BENEFITS OF PLANNING AHEAD

First off, let's take a look at the new law's benefits for manufacturers that have already been claiming the credit.

Since it was first introduced over three decades ago, the R&D Tax Credit has—until now—been a temporary tax credit, one that has fortunately stood the test of time and been extended and expanded on multiple occasions by Congress over the years. However, as most CPAs and business owners familiar with the credit will tell you, the constant end-of-year extensions haven't exactly been good policy for businesses in terms of planning ahead for the future. The lack of year-to-year certainty has indeed been a factor in driving perfectly eligible companies away from the credit, with unpredictability making business owners wary to base any future investments—be it for new employees, new equipment or further R&D expenditures—on a federal tax incentive that could potentially not exist in future years.

Now, due to the PATH Act of 2015, those worries are a thing of the past. With permanency comes certainty, and manufacturers and other businesses will now be able to tailor their future processes and R&D investments knowing full well the credit will be around to offset the costs. Additionally, with the credit now a permanent fixture for every qualifying businesses' tax-planning strategy, for the first time ever business owners will be able to adequately invest their funds with the credit in mind.

AMT TURNOFF: THE BEST TAX NEWS IN DECADES

Now, on to the major game-changer for the manufacturing industry—the AMT turnoff for the R&D Tax Credit.

In the past, the greatest barrier preventing manufacturers (particularly small and mid-sized manufacturers) from claiming the R&D Tax Credit was the alternative minimum tax (AMT) floor. Without getting too involved in the complexities of the tax code, the key thing to know is that the majority of small and mid-sized manufacturing businesses (and really small and mid-sized businesses in general) are organized as pass-through entities, and are as such taxed at the owner's individual tax rate. In the past, this would often lead to the owner being subject to the AMT floor, meaning that even if a business had engaged in activities that would normally qualify them for the R&D Tax Credit, that business would still effectively be barred from what can be significant tax savings (as seen from federal savings gained from the tool and die example mentioned before).

Now, with the new legislation, those days are behind us. With Congress seeing an obvious shortcoming in the ability of innovative small and mid-sized companies to take advantage of the credit, starting in 2016 the PATH Act effectively turns off the AMT bar for "eligible small businesses" (defined by the legislation as businesses with less than $50 million in average gross receipts for the prior three years) that qualify for the R&D Tax Credit.

While on the surface this may appear like technical, in-the-weeds tax jargon, rest assured this modification is huge news and will have a lasting impact on both U.S. businesses and the manufacturing sector at large. The removal of the AMT barrier is estimated to allow for a ten-fold increase in the number of small businesses that can utilize the R&D Tax Credit—and with manufacturers being among the greatest candidates for the credit, this single modification could add billions of dollars in additional funds to the sector over the next few years.

Keeping into account these new rules, manufacturers who were turned away from the credit by the IRS in the past or—due to uncertainty surrounding the tax laws—avoided applying for the credit altogether, would be wise to take a second hard look at the new and improved R&D Tax Credit. In a competitive marketplace, it could mean all the difference in ensuring the growth and success of a manufacturing business.

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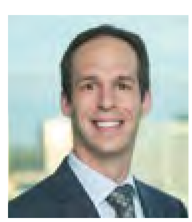

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