THE R&D TAX CREDIT: MAJOR CHANGES, BIG TAX SAVINGS FOR STARTUPS, SMALL BUSINESSES

Friday, February 12, 2016

by Dean Zerbe, *former Senior Counsel to the U.S. Senate Finance Committee and alliantgroup National Managing Director*

This year is already shaping up to be a banner one for startups—and believe it or not, CEOs and investors of these innovative software and technology companies have Congress to thank.

In December, as part of the bipartisan tax deal reached by Congress and signed into law by the president, the federal Research and Development (R&D) 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 credit out there for U.S. businesses —and due to Herculean congressional efforts, eligible companies will now move forward certain of the credit's future when considering their investments.

And, not only was the credit made permanent for the first time in its 34-year history, but starting in 2016 the R&D Tax Credit 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 of our nation's most 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, the majority of our 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, starting in 2016, startups (in this instance, defined as businesses with gross receipts of less than $5 million a year) will be able to 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 it for around $100,000 in federal credits was unfortunately barred from its 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 its payroll taxes down to $8,500. The net gain—$100,000 in added tax savings—which 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 (in this instance, 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 (AMT). This removes the single greatest barrier that prevented companies from taking advantage of the credit in the past.

Combined together, these two changes will mean well over $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.

INDUSTRIES THAT ARE AFFECTED

Quite frankly, this is probably the biggest news on taxes for innovative startups in years, and 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 will now have access to these valuable tax savings. In the past, we have found companies in fields as diverse as architecture, engineering, construction, apparel and aerospace (and that's just to name a few) to be great candidates for the R&D Tax Credit. And, thanks to the new tax deal, more companies will have yet 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 R&D Tax Credit.

And thanks to Congress, more and more businesses will be able to reap the credit's tax benefits for the first time.

• • •

Dean Zerbe is alliantgroup's National Managing Director based in the firm's Washington, D.C. office. Prior to joining alliantgroup, Zerbe was Senior Counsel and Tax Counsel to the U.S. Senate Committee on Finance. He worked closely with then-Chairman of the Finance Committee, Senator Charles Grassley, on tax legislation. During his tenure on the Finance Committee, Zerbe was intimately involved with nearly every major piece of tax legislation that was signed into law, including the 2001 and 2003 tax reconciliation bills, the JOBS bill in 2004 (corporate tax reform) and the Pension Protection Act. Zerbe is a frequent speaker and author on the outlook for short-term and long-term changes in tax policy, as well as ways accounting firms can help their clients lower their tax bill.

http://www.cnybj.com/News/Articles/TabId/102/ArticleId/42907/language/en-US/the-rd-tax-credit-major-changes-big-tax-savings-for-startups-small-businesses