REBOUNDING WITH THE R&D TAX CREDIT

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Your manufacturing clients/employers are due for some good news, and as their CPA, you finally have some to share. Amidst discouraging job losses in recent years and tepid reports about business growth (unemployment finally went down to 5.6 percent in March 2016), one recent legislative development should give Kentucky's manufacturing industry the utmost confidence that they are headed down the path of an industry upswing.

With spring's tax filing deadlines barely behind us, and with extension deadlines coming up in a few months, this interval is the perfect time to get familiar with the major effort Congress has made to strengthen and grow the U.S.'s industrial economy—and manufacturers are among those best positioned to benefit from their good work.

An underutilized tax incentive is presenting a compelling opportunity to manufacturing businesses—the Research and Development (R&D) Tax Credit is providing business owners with the on-hand capital needed to hire more labor and expand operations. Local manufacturers now have the potential to build on the momentum of the job increases in the last year.

The PATH Act of 2015 Changes Everything

At the end of last year, Congress enacted the Protecting Americans from Tax Hikes (PATH) Act of 2015, a landmark piece of legislation with major implications for U.S. manufacturers. What CPAs might find most compelling about this legislation is that it both makes permanent the Research and Development Tax Credit, and includes major enhancements that permit businesses effectively barred from the credit in the past.

Previously, a massive number of small to mid-sized companies were effectively barred due to the alternative minimum tax (AMT) bar, a barrier that often prevented qualifying companies from taking advantage of the R&D credit. Now, due to a key PATH Act modification starting in 2016, the AMT barrier is effectively removed for small to mid-sized businesses (defined by the legislation as businesses with less than $50 million in average gross receipts for the prior three years). The PATH Act also includes another provision beginning in 2016 that grants access to the credit for startup businesses, allowing qualifying companies with less than $5 million in gross receipts to claim the credit on their payroll taxes. With these key modifications, newly qualifying businesses could pump an additional $2 billion back into our economy.

Manufacturers Top Qualifiers and Top Deniers

Of the estimated $10 billion in annual tax savings for U.S. companies claiming the R&D Tax Credit, the IRS reports that manufacturers make up the largest amount of credit claims (39.2 percent), and rightfully so. Manufacturing is responsible for over one-third of U.S. GDP (*Manufacturing Alliance for Productivity and Innovation*), and despite what the name of the credit may imply (i.e. basic or laboratory research), this incentive was very much designed with manufacturers in mind. Simply put, the applied sciences count toward eligibility as well, with the credit rewarding the everyday technical problem solving manufacturers must go through to improve their products or production processes—in other words, the steps that are taken or the trial-and-error work that is required in making a product or process cheaper, faster, cleaner or more efficient.

R&D CREDIT MANUFACTURING CASE STUDIES

MOLDED TOOLS MANUFACTURER
ANNUAL REVENUE: **$4** MILLION
RESULT: **$70,000** IN FEDERAL CREDITS

MANUFACTURER OF HIGH-TECH ARMOR DEFENSE
ANNUAL REVENUE: **$16** MILLION
RESULT: **$787,000** IN FEDERAL CREDITS

PLASTIC INJECTION MOLDING CO.
ANNUAL REVENUE: **$35** MILLION
RESULT: **$192,000** IN FEDERAL CREDITS

FOOD PROCESSING MANUFACTURER
ANNUAL REVENUE: **$81** MILLION
RESULT: **$415,000** IN FEDERAL CREDITS

MULTI-TOOLS MANUFACTURER
ANNUAL REVENUE: **$87** MILLION
RESULT: **$3,689,240** IN FEDERAL CREDITS

If you're wondering what the real-world application of the credit looks like, take, for example, an **automotive safety manufacturer with yearly gross receipts of $17.2 million. The company qualified for the R&D credit thanks to its high-impact crash testing and firmware development for impact sensors, receiving over $1.3 million in federal R&D credits.** This is really something to perk up to considering Kentucky is home to a substantial number of manufacturers compared to other states.

Considering these numbers, it's fair to say that the R&D Tax Credit represents perhaps the greatest opportunity for manufacturing companies to grow and reinvest in their businesses. Kentucky's major economic driver is the manufacturing of motor vehicles and motor vehicle parts, which accounts for more than 85,000 jobs at four auto assembly plants and 475 other vehicle-related facilities. The food production, chemicals and machinery manufacturing subsectors follow in productivity. The state's total 231,000 manufacturing jobs operating in more than 3,700 manufacturing establishments (*National Association of Manufacturers*) make up 11 percent of Kentucky's labor force; that's the eighth highest in the country. If you have qualifying manufacturing clients, those numbers are certain to work in your favor.

Despite being hyped as one of the best industries for this opportunity, the R&D credit is still under-claimed by most qualifying manufacturing businesses. The *Wall Street Journal* estimates that only five percent of qualifying companies claim the R&D credit and manufacturers (considering their host of qualifying activities) are among the guiltiest offenders when it comes to overlooking what can be significant tax savings.

And it's not just the taxpayers who are culpable. CPAs are also underestimating the credit and letting millions of dollars slip by every tax season—though it's important to point out that there is an opportunity to amend your client's returns, going back as far as three or four years.

For the CPAs who haven't re-evaluated what the R&D Tax Credit looks like in 2016, it's time to take another look. Failing to explore a client's eligibility, frankly, could be one of the biggest (and costliest) mistakes a CPA could make.

Greg Knarr joined alliantgroup in 2010 as a Director based out of Indianapolis and represents much of the company's Midwest territory. Greg is an expert on the Research and Development (R&D) Tax Credit, and plays a vital role in alliantgroup's mission to strengthen U.S. businesses by helping to reduce tax liability. Before joining alliantgroup, Greg worked with over 100 CPA firms across the nation as the founding partner of Hull & Knarr, with a concerted effort in the R&D Tax Credit for the Midwest region of the U.S.