

## AREA DEVELOPMENT

# THE R&D TAX CREDIT – A GAME-CHANGER FOR MANUFACTURERS

**RECENT LEGISLATION MAKING THE R&D TAX CREDIT PERMANENT IS A BIG BOON TO MANUFACTURERS OF ALL SIZES, HELPING THEM TO INNOVATE AND EXPAND.**

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It is no secret that policymakers in Washington are highly supportive of domestic manufacturing. Unfortunately, what is a secret is the big tax break intended to help manufacturers—the Research and Development (R&D) Tax Credit. Far too many manufacturers—probably 75-80 percent—fail to understand that they may qualify for the R&D Tax Credit—the largest tax credit provided to businesses by the federal government (roughly \$10 billion a year).

Why the huge number of manufacturers who don't know that they could benefit from this tax credit? Self-censoring is the main reason. Manufacturers have either outdated or incorrect understandings of what qualifies for the R&D Tax Credit—and also are understandably unaware of some recent changes in the law that have greatly expanded who can benefit from the credit.

The key for those in manufacturing to understand is that the R&D Tax Credit is not just about basic research, but also about applied research. The R&D Tax Credit encourages and rewards manufacturers who are bringing a new or improved product to market (as well as manufacturers who are improving the manufacturing process itself—making a product quicker, cheaper, greener, etc.). In short, unless your company has been making the exact same product the exact same way for the past 10 years, your company may be a good candidate to consider for the R&D Tax Credit.

### Some Examples

A classic example of a manufacturer that can benefit from the R&D Tax Credit is a small manufacturer that does secondary automotive manufacturing for a big carmaker. Here, it is a production process that qualifies for the R&D Tax Credit. The small manufacturer is provided the designs of the parts that it is contracted to develop, and its prototyping and development is the manufacturing process and the assembly line itself. In addition to the qualified prototyping of the parts from the assembly line, the small manufacturer is also ensuring functionality, reliability and quality of the parts. The heart of development is the assembly line and the manufacturing processes to develop the parts that the big carmaker utilizes for the final automobile. The small manufacturer is removing inefficiencies, improving the cycle time and improving process performance of the assembly line, which also includes ensuring the reliability and quality of each part created from the assembly line they developed.

In this case, this small manufacturer qualified for an R&D Tax Credit of just over **\$1 million** (qualifying the manufacturer for all four open tax years as well as for the state R&D Tax Credit—roughly 40 states have a state R&D Tax Credit). Needless to say, this tax savings was a huge game-changer for this small manufacturer, allowing the company to expand its operations. Also note, the fact that the small manufacturer was being paid by the big carmaker to perform this work did not, in this case, disqualify the small manufacturer from obtaining the R&D Tax Credit.

In other recent examples, **a steel ring manufacturer received \$406,000 in federal credits** for design improvements in its product; **a molded plastics company received over \$200,000 in federal and state credits;** and **a manufacturer specializing in high-injection-molded components received \$330,000 in federal and state credits.** As you can see, the manufacturing companies that qualify for the R&D Tax Credit run the gamut.

### What Work Can Qualify?

alliantgroup has worked with thousands of manufacturers across the country to secure the R&D Tax Credit—including those active in iron casting, sheet metal plating, hot stamping, injection molding, plastics, etc. Examples of manufacturing innovations eligible for the R&D tax incentive include:

- Innovating product development using computer-aided design tools
- Developing second-generation or improved products
- Tooling and equipment fixture design and development
- Designing innovative manufacturing equipment
- Prototyping and three-dimensional solid modeling

Similarly, on the production process side, eligible R&D tax incentives include:

- Designing and developing cost-effective and innovative operational processes
- Integrating new materials to improve product performance and manufacturing processes
- Designing and evaluating process alternatives
- Designing, constructing and testing product prototypes
- Achieving compliance with changing emissions laws and regulations
- Streamlining manufacturing processes through automation
- Improving product quality and yields
- Reducing manufacturing times and optimizing manufacturing processes

### Not Just for the Big Boys

While the big manufacturers in the Fortune 500 take full advantage of the R&D Tax Credit, there certainly is no bar to small and medium-sized manufacturers taking the R&D Tax Credit. In fact, recent changes in law and regulations have actually made it much easier for small and medium-sized businesses to utilize the R&D Tax Credit, and especially for manufacturers to increase their tax savings.

### Some Examples

The biggest news from Washington, D.C., was that, first, the R&D Tax Credit was finally made permanent law. For years and years, the credit was extended one or two years at a time. In December 2015, Congress passed and the President signed a major tax law that had as a key piece making the R&D Tax Credit permanent. Businesses can now have much greater confidence in planning on the tax savings of the R&D Tax Credit.

The second piece of good news is that Congress—thanks to Congressman Brady (R-TX) and Senators Grassley (R-IA) and Roberts (R-KS)—also made the R&D Tax Credit good against the alternative minimum tax (AMT). This may sound yawning even to tax geeks—it is not. The number-one impediment to small and medium-sized manufacturers from utilizing the R&D Tax Credit was that they couldn't use their credit to reduce their tax liability below their AMT. Now they can...this is big...very big. If you were told in the past that you couldn't benefit from the R&D Tax Credit, ask again.

Third, Congress—thanks to Senator Coons (D-DE) as well as Senator Schumer (D-NY)—also allowed the R&D Tax Credit to be eligible for startups for the first-time with the tax legislation passed this December. So now a new, innovative manufacturer who is in the early stages (not making a profit but still facing payroll taxes) can potentially be eligible for a refundable R&D Tax Credit of up to \$250,000 per year.

Finally, the Treasury (in response to some decisions in the courts) has provided a more expansive view of what supply costs can be included for the R&D Tax Credit. These changes in the regulations are particularly welcome for manufacturers, and especially manufacturers who are engaged in making a single unique item for a customer (example, a boat).

Yes, it's hard to believe—good news coming from Washington for manufacturers. However, as they say, “showing up” is still required by manufacturers to qualify and benefit from the R&D Tax Credit. While the Congress has made it easier for manufacturers to qualify and utilize the R&D Tax Credit, the IRS isn't just handing money out. However, after years of experience in this field, we've found that it's fairly straightforward to determine whether a specific manufacturer is a good candidate for the R&D Tax Credit and to have the proper paperwork in place to make the IRS happy (well, happier).

Congress, on a bipartisan basis, wants to encourage and support good-paying manufacturing jobs in this country and to also foster innovation. The R&D Tax Credit is the key tax policy that Congress has put in place to accomplish that goal. Sadly, most small and medium-sized manufacturers do not take advantage of the huge tax savings provided by the R&D Tax Credit. As manufacturers look ahead—expanding, growing and innovating—the R&D Tax Credit is an important way to ensure that they have the dollars they need to invest in a better tomorrow. **a**



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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.