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## R&D TAX CREDIT: AN OPPORTUNITY FOR DISTRIBUTORS, OEM CHANNEL PARTNERS AND VALUE-ADDED RESELLERS

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*“Prior to engaging for an R&D Tax Credit study based on our CPA’s recommendation, I had heard of the incentive but thought it only applied to big companies. However, this study opened my eyes to the excellent opportunity available to my company and others like us through the R&D Tax Credit.”*

– Ron Herem, President of Baldwin Supply Company, a PTDA member

### What does “research and development” have to do with being a distributor?

According to the federal government, quite a bit. In fact, going by our government’s definition (at least as it relates to the world of tax), “R&D” is actually much more prevalent within this niche industry than the average distributor, OEM channel partner or value-added reseller may realize.

The reasons for this are quite simple. What these types of companies all have in common is a commitment to improving infrastructure or industrial processes, and the truth is that many of these exact types of activities qualify for the Research and Development (R&D) Tax Credit—one of the most valuable tax incentives available for the benefit of U.S. businesses. Producing an estimated \$10 billion in annual tax savings for U.S. companies, the R&D Tax Credit can offer a significant financial boost for any business, often providing the extra capital needed to hire new employees, purchase new equipment or reinvest in other long-term initiatives.

Case in point, **one industrial controls and value-added reseller received over \$747,000 in federal credits for three years’** worth of qualifying projects. Due to a broad range of contributing factors, this company received a six-figure result that is quite common for companies within this space.

To further understand why these companies are often such great candidates, let’s take an in-depth look at the credit and how it specifically applies to the work of distributors, OEM channel partners and value-added resellers.

### THE REWARDS FOR ENHANCING PRODUCTIVITY AND EFFICIENCY

Whenever I first introduce the R&D Tax Credit, the main point that I always try to get across is how the tax code’s definition for R&D is much more expansive than what the average person associates with the words “research and development.” Despite what the name may imply, the credit is not just about patents, test tubes, medical facilities or Silicon Valley startups. It’s not just about Google, Apple or other large tech companies.

No, the credit is also very much about the applied sciences, or the technical, everyday problem-solving companies must go through to improve products or processes. It is the trial-and-error work performed on the factory floor to improve a product, the iterative steps devised by engineers to enhance the efficiency of a systematic process, or the technical work done to ensure that multiple systems and

components are able to communicate with one another that are often the common paths toward eligibility for distributors, value-added resellers and OEM channel partners.

By their very nature, it is the main focus of these companies to develop technical solutions that will help their clients, be it solutions that improve company equipment, production rates or those that are designed to make a factory safer and more cost-efficient. As such, the work of these companies is very much in line with the kinds of activities the credit was designed to reward.

The bottom line—if your company is helping to improve products or processes through technical know-how (especially if those improvements are designed to enhance productivity and efficiency within a client’s facility), your company more than likely qualifies for the R&D Tax Credit.

### REAL-WORLD APPLICATION

For a real-world example, let’s go back to the value-added reseller that I mentioned in the beginning and breakdown one of the projects that led to that generous credit result.

Among its many qualifying projects, this company designed and developed a custom valve automation system for the monitoring of valve positions at a facility. Specifically, the company was tasked with designing a continuous monitoring system to control the valves, requiring the development of built in sensors and transmitters to allow the system to communicate with the entire building.

During development, the company tested and investigated multiple existing systems and eventually determined the need to utilize brackets (along with sensors) that would identify the location of the valves. The company also evaluated several different communication components, including wireless transmitters and sensors, leading to the eventual decision to attach proximity probe sensors to the brackets to produce a reliable monitoring system.

Finding technical solutions to real-world challenges—that is the key way that distributors, OEM channel partners and value-added resellers can qualify for the R&D Tax Credit. While this particular example relates to the development of an automated safety system, companies

within this space must often overcome the same issues when developing (or improving upon) standard automated or industrial systems.

### OTHER QUALIFYING EXAMPLES

To provide further insight into how companies from this industry qualify, here is a list of activities that have qualified businesses in the past (but bear in mind, this is by no means a comprehensive list):

- **Providing clients with products and services that increase production rates, reduce waste and improve quality**
- **Assisting with custom design and engineering**
- **Providing turnkey solutions**
- **Providing motion control solutions and assembly services**
- **Enhancing services with in-house engineers or technical sales/support staff**
- **Designing, customizing, fabricating or prototyping of parts and equipment**
- **Integrating systems for optimal performance**
- **Designing and engineering control panels**
- **Providing management software for in-house tracking, ordering and supply chain**
- **Developing specialty conveyors, material handling and packaging systems**
- **Operating CAD/CAM and CNC machining**

### EXPANDING CREDIT OPPORTUNITIES

As you can see, the R&D Tax Credit has a much broader application than many within this industry may realize. Additionally, due to legislation signed into law just this past December, the number of total U.S. businesses eligible for the credit is set to dramatically increase this year, which is outstanding news for companies from an industry with that many qualifying activities.

## THE STARTUP PROVISION

The first of these—the startup provision—effectively opens the credit up to startups, allowing businesses with gross receipts of less than \$5 million a year to claim the credit (capped at \$250,000) against their 2017 payroll taxes. Since its inception, one of the real shortcomings of the R&D Tax Credit was that newer companies, which are traditionally more likely to take risks and invest in improving their products or processes, could not utilize the credit. As such businesses rarely turn a profit in their first few years, and thus do not pay federal income tax, these companies were effectively prohibited from claiming the credit. This provision solves that issue and will be tremendously beneficial in expanding the credit to newer companies.

## THE AMT TURN-OFF

The second modification—the AMT turn-off—allows small businesses (defined in this instance as businesses with less than \$50 million in gross receipts) to be able to claim the credit against their alternative minimum tax (AMT). Without getting too involved in the intricacies of the tax code, the important takeaway here is that the AMT floor was the single greatest barrier preventing perfectly eligible companies from claiming the R&D Tax Credit. Now that barrier has been removed—and small to mid-sized distributors, OEM channel partners and value-added resellers are set to benefit heavily due to its removal.

Keeping these new modifications in mind and the plethora of activities that can qualify for the credit, if you haven't explored the R&D Tax Credit in the past, now would be the time to do so. It may be the easiest money you ever make for your business.



**Tracy Lustyan** is an expert on the Research and Development (R&D) Tax Credit and how it applies to innovative businesses. As a Managing Director at alliantgroup, Tracy has partnered with more than 120 CPA firms to uncover significant government-sponsored tax savings for more than 450 companies operating in diverse industries, including manufacturing, systems integration, engineering and software.