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Tax Update

Take Advantage of Opportunities for R&D Credit

First enacted in 1981, the Research & Development (R&D) Tax Credit is one of the most valuable tax credits available to businesses today. The credit was finally made permanent in the Protecting Americans from Tax Hikes (PATH) Act of 2015, which makes planning much more feasible for companies that apply for it.

U.S. companies claim \$11.3 billion in R&D credits annually. Many large manufacturing and distribution companies have taken advantage of the credit for years, but small and midsize companies can also qualify in many circumstances. M&D companies make 60 percent of the total credit.

How to Qualify

To qualify for the R&D credit, your company must pass a statutory four-part test for eligibility:

- 1. New or improved product or process:** You develop a new product, process, formula, invention, technique, software, or you improve an existing one, intending to enhance function, performance, reliability or quality.
- 2. Technological in nature:** Your activities are technological in nature based on the physical, sciences, biological sciences, chemical sciences, computer science or engineering principles.
- 3. Elimination of uncertainty:** You try to eliminate technological uncertainty related to the development or improvement of a product or process related to capability, method or design.
- 4. Process of experimentation:** You evaluate alternatives for achieving the desired outcome using modeling, simulation, testing or systematic trial and error.

There are a number of different qualifying activities that could meet these criteria for manufacturers and distributors. One is developing custom equipment or processes to produce a product to exact customer specifications.

Developing a prototype or model of a new product or process and designing tools, jigs, molds and dies are other activities that might qualify. Attempting to use new materials or designing, developing or modifying equipment also might meet the qualification test.

The PATH Act also opened the door for companies to utilize even more of R&D credit claimed. For example, for tax years beginning after December 31, 2015, businesses with an average gross receipts of \$50 million for the prior three years can claim the credit against their Alternative Minimum Tax (AMT) liability.

Start-up companies also have an R&D tax credit opportunity. If a company did not have gross receipts for any tax year before the five-tax-year period ending with the calculation year and has annual gross receipts less than \$5 million in the current year, the R&D credit can be used to offset up to \$250,000 in payroll taxes.

Documentation Required

If you apply for the R&D credit, be sure your recordkeeping is up to date. You must be able to provide documentation to substantiate eligible expenditures.

Finally, note that if your company is unable to use the credit in the current year, it can be carried back one year and forward 20 years to offset past and future tax liabilities. Your company can also amend prior year returns to claim the credit.

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We have a team of over a dozen professions, including engineers, that focus on the R&D tax credit. Let's talk about how your company might qualify.



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