



**THE GREATEST TAX SHELTER
YOU NEVER HEARD OF
FOR YOUR COMPANY**



- The Protecting Americans From Tax Hikes (“PATH”) Act was signed into law December 18, 2015
- The PATH Act made THREE major changes to the R&D Tax Credit
 - First Change: **R&D Tax Credit has been Permanently extended**
 - Second Change: **R&D Tax Credit can offset Alternative Minimum Tax (AMT)**
 - Third Change: **R&D Credit can offset payroll tax**



- Allows qualified startup businesses to claim up to \$250,000 of the R&D tax credit against their payroll taxes
- A qualified startup is defined as a company with less than \$5 million in gross receipts and no gross receipts for any tax year preceding the five tax year period ending with the tax year
 - If first year of election is 2016, must have had no gross receipts in a tax year preceding 2012
 - 2012-2016 – must have less than \$5 million in gross receipts
 - 2011 prior- must have zero gross receipts
- Can not make election for more than 5 years
- Gross receipts are not required (companies with no gross receipts can make the election and use the credit).



- For companies that are not a partnership or S corporation, only the amount of the R&D credit that would be carried forward can be applied against the payroll tax
- Election starts the first quarter after the return is filed
 - If return is filed March 2017, would be able to use the credit against payroll taxes generated the 2nd quarter of 2017
- *Good Candidates for the payroll election:*
 - Software and biotech company startups will be a rich target
 - Loss position companies generally have not wanted to take the credit, because they did not know when it could be used
 - Companies that have little or no tax liability



- **Qualified startup companies that have a small tax liability or have been in a NOL position can now use the credit to receive a benefit instead of carrying forward the credit**
- **ABC Company began operations in 2015.**
- **ABC is not expecting gross receipts until 2017.**
- **ABC had qualified payroll taxes of \$125,000 in 2016 and a \$200,000 R&D credit for 2016.**
- **ABC will file their 2016 tax return in March 2017 and apply the credits to their payroll tax expenses. Unused credits will be carried forward.**

Before law change R&D Credit Utilization = \$0

After law change 2016 R&D Tax Credit = \$ 125,000*

Legislative Update – AMT Reduction



- Eligible small businesses can use credit to offset **AMT** for tax year beginning after December 31, 2015
 - An ***eligible small business*** is defined as having an average of \$50 million or less in gross receipts the prior three tax years
 - Controlled group gross receipts calculation still applies
 - Cannot be a publically traded company
 - Provision is similar to the AMT relief in 2010
 - 2016 credits will first be applied to reduce AMT
 - Unused credits can be carried back or forward.

How the Federal Credit Can Be Monetized



- Many professional service industries, such as A&E, owners have typically been unable to take the credit, will now have an opportunity to benefit from R&D
- S Corps – Credit flows through to the owners
 - A lookback study should be performed in conjunction with an estimate 2016 study
 - Law changes can assist in reducing estimated tax payments for 2016
 - If a company does not have enough 2016 credit to reduce full tax liability, the prior years' credits will be valuable
 - Eligible small businesses that could not take the credit due to AMT in the past should be reevaluated
 - If a company was only able to take the credit in 2010, they likely will benefit from this law change

R&D Credit Benefits



- Federal Tax Benefit : 6.5% of Qualified Research Expense (QRE)
- Lowers effective tax rate
- Improves earnings per share
- Many states have an R&D credit
 - Nonrefundable credits
 - California: 15%, nonrefundable, unlimited carryforward
 - Illinois: 6.5% nonrefundable, 5 year carryforward
 - Refundable credits
 - Virginia: 15%, 20% (if done with Virginia Universities), refundable
 - Arizona: 24%, partially refundable, eligible small businesses, 15 year carryforward
 - Connecticut: 6.5%, \$.65 cents per dollar for small business C Corporations
 - Iowa: 6.5%, 4.55% fully refundable after tax liability is paid
 - Maryland: 3%, 10%, for credits generated after December, 15, 2012

State R&D Credits



37 states offer an R&D credit, many in addition to the federal credit:

Arizona	Hawaii	Maryland	New York	Texas
Arkansas	Idaho	Massachusetts	North Carolina	Utah
California	Illinois	Michigan	North Dakota	Vermont
Colorado	Indiana	Minnesota	Ohio	Virginia
Connecticut	Iowa	Nebraska	Oregon	Wisconsin
Delaware	Kansas	New Hampshire	Pennsylvania	
Florida	Louisiana	New Jersey	Rhode Island	
Georgia	Maine	New Mexico	South Carolina	

Applicable Industries



- Aerospace
- Apparel
- Architectural & Engineering
- Automotive
- Chemical
- Computer Software
- Cosmetics
- Electronics
- Engineering
- Equipment
- Food & Beverage
- Hardware Development
- Manufacturing
- Medical
- Pharmaceuticals
- Telecommunications
- Tooling, jigs, molds
- Numerous others

Applies Across ALL Industries!!!

R& D CREDIT TEST

4 PARTS - NEET

1. New or Improved Product or Process

Must improve performance, functionality, quality, reliability or cost

2. Elimination of Uncertainty

3. Experimentation Process

4. Technological in Nature

Must rely on hard sciences- ie. physics, engineering, chemistry,
biology,
or computer science

R&D 4-Part Test



1. Permitted Purpose

New or Improved Business Component

- ◆ Function
- ◆ Performance
- ◆ Reliability
- ◆ Quality

3. Process of Experimentation

- Evaluate one or more alternatives in an attempt to resolve uncertainty
 - ◆ Evaluate alternatives
 - ◆ Develop hypothesis
 - ◆ Test hypothesis
 - ◆ Evaluate results
 - ◆ Refine hypothesis
 - ◆ Success or failure
- Substantially all activities ($\geq 80\%$) must constitute elements of a process of experimentation

2. Elimination of Uncertainty

- Uncertainty related to business component
 - ◆ Capability or method of developing or improving
 - ◆ Appropriate design

4. Technological in Nature

- Activities must rely on:
 - ◆ Physical sciences
 - ◆ Biological sciences
 - ◆ Engineering
 - ◆ Computer science

SUMMARY: New Changes in the Law

Existing companies can go back up to 3 open tax years
And recoup credits

Startup companies can use R&D credits up to \$250,000
In Federal Payroll taxes per year

Unused R&D credits can be carried forward up to 20 years

FOR ADDITIONAL INFORMATION

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**“We return your personal and corporate tax liabilities
into earning assets”**