

Game-changer puts lucrative R&D credits within reach

By Mark Dunning

If your business has never claimed the federal research and development (R&D) credit before or dismissed it due to eligibility restrictions, it's time to take another look. Two recent options are giving companies previously shut out of the world of R&D credits access to these lucrative rewards to help grow their business.

What's new

Since the early 1980s, the federal research tax credit (section 41) has been used to reward innovation and job creation. But until now, a large number of U.S. companies engaged in R&D did not have an avenue to take advantage of what was typically seen as a "big company credit."

That has changed with the passage of the Protecting Americans from Tax Hikes (PATH) Act of 2015. This Act made the R&D credit permanent and expanded eligibility to smaller and newly launched companies. Now businesses of all sizes may be rewarded for making new or improved products and processes.

Here's how you can take advantage of the opportunity to save.

Small business option to offset Alternative Minimum Tax

Eligible small businesses whose R&D credits may have been limited by the Alternative Minimum Tax (AMT) in the past can now use the R&D tax credit to offset AMT. Credits generated in 2016 can be used to reduce a company's AMT tax liability, freeing up cash that can be reinvested in the business. Eligible small businesses can be sole proprietorships, partnerships, S Corporations and non-publicly traded corporations with \$50 million or less in average gross receipts for the prior three years.

Start-up company option to offset payroll tax

Start-ups that perform R&D activities during the early stages of their operations can now greatly benefit from generous tax savings—even before they turn a profit. The option to elect to offset the R&D credit against payroll tax (the employer's portion of the 6.2% Social Security tax) may especially benefit any eligible start-up that has little or no income tax liability.

To take the credit against payroll taxes, a business must have gross receipts of \$5 million or less in the tax year of the claim and no gross receipts in any tax years preceding the last five years (including the year of the claim). This means for tax year 2016, the company couldn't have had gross receipts in 2011 or earlier, although it could have been operating and incurring start-up type expenses.

An eligible small business with qualifying research expenses can choose to apply up to \$250,000 of its research credit against its payroll tax liability. Once annually elected into payroll tax, credits in excess of current payroll taxes can be carried forward to subsequent quarters until fully depleted.

When to apply

As a newly eligible small business or start-up company, you can start to claim your R&D credits with your 2016 federal income tax return this tax season. According to the Internal Revenue Service, those who already filed still have time to make the claim. Under a special rule for tax-year 2016, a small business that failed to choose this option can still make the election by filing an amended return by Dec. 31, 2017.

The small print

New and revised forms accompany the expanded eligibility provisions and include:

[Form 6765](#) entitled “*Credit for Increasing Research Activities*” has been finalized so companies can make an annual election specifying the amount of R&D credits to be applied to the employer-portion of Social Security tax. Section D of Form 6765 is where a company makes the election to offset payroll tax with the research credit in the quarter after the tax return is filed and in subsequent quarters until fully utilized.

[Form 8974](#) entitled “*Qualified Small Business Payroll Tax Credit for Increasing Research Activities*” is a new form that businesses will use to report the amount of R&D credits elected on Form 6765 to offset Social Security tax. The form will be filed with Form 941 each quarter that the credit is applied to the Social Security tax liability.

[Form 941](#) for 2017 entitled “*Employers Federal Quarterly Tax Return*” is a new version of the form used to illustrate the amount of payroll tax to be paid and provides the amount of R&D credit to be utilized to offset payroll tax, which is reported on Form 8974 each quarter.

The Takeaways

Now is the time to see if your activities qualify your business for these rewards. Filing a federal R&D credit claim requires detailed records that highlight how expenditures satisfy a four-part test for the credit: (1) technical uncertainty, 2) process of experimentation, 3) technological in nature, and 4) qualified purpose.

Gathering the necessary support documentation the IRS expects you to have at the time you file for the R&D credit is time consuming so you'll want to get it right from the start. The nature and content of your documentation and filings will dictate whether the IRS deems your activities credit worthy or not.

The R&D credit is an area of focus for the IRS. **Despite the permanent nature of the R&D credit, filing a claim doesn't guarantee you'll get the credit.** If you are unfamiliar with best practices for successful claims, contact your [TaxOps Advisor](#) to help guide the interview, data gathering, reporting and defense process for your business.

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