

PRODUCTS

PF

FINISHING

www.pfonline.com

JANUARY 2012

VOL. 76 NO. 4

RADIO DAYS

Using RFID to track plating operations

Feathers for a Fantastic Finish (20)
Buffing & Polishing Safety (24)

Finishing Shops Can Take Government R&D Tax Credits

The tax break that can be your big break.

The R&D tax credit, more formally known as the Credit for Increasing Research Activities, has been around since 1981, and yet many finishing business owners have never heard of it or falsely think they don't qualify.

Unlike a tax deduction, the R&D tax credit is a dollar-for-dollar reduction of your tax liability. Making the R&D tax credit even more lucrative for your finishing business is the fact that, in addition to the current year's tax savings, you can claim the credit up to three open tax years back and receive your "overpaid" taxes with interest.

Typical job shops may benefit upwards of \$100,000. Furthermore, many states have adopted similar tax credits that can add on to, or sometimes even double, your company's tax advantage.

Who can get it? The credit is available to all taxpayers that design or develop new or improved products, processes, techniques, formulas, inventions or software. Further, these items only need to be new or improved to you, not the industry at large. As such, the number and types of companies that can qualify for the credit is much broader than what you might traditionally consider R&D.

What activities qualify as R&D? Surprising to most finishing shop owners, many of their daily activities are "Qualified Research Expenses" (QREs) under the R&D tax credit as defined by the IRS. The definition of a QRE is broad and includes: figuring out methods or processes to accomplish new goals; developing or improving products, processes or formulas; designing or improving manufacturing processes; quality assurance activities; creating prototypes and models; first article runs and more.

Within those categories of QREs, companies can capture the wages paid to employees who have not only a direct role in the activity, but managers who supervise those employees and support personnel who help facilitate the process. On top of that, businesses can capture 65 percent of qualified research expenses carried out by contractors and 100 percent of all supplies used and consumed in the activity. This allows small companies not to lose out on the credit that seems more identifiable in companies with established research programs.

For example: If your shop foreman develops and changes a powder coating process and your quality control engineer tests it, you can qualify the time of both employees and the cost of the supplies used. Any effort to technically improve your business or products/processes is likely a QRE.

What benefit will I see? While the amount of QREs a company has in any given year is the driving force behind

the credit, there are other factors that can have an effect on calculating the credit for the company.

Assume you own a company in South Carolina where you design and produce coatings for military parts and the processes to apply them. You have a payroll of around \$4 million dollars with approximately 25 percent of your employees' time dedicated to figuring out the best coating to achieve the project specifications and the best method to apply the coating to ensure the part is still within the specified tolerances (\$1,000,000 in QREs). If these QREs had remained constant over the prior three years, you would be entitled to a net federal tax benefit of \$45,500 for the current year. If you had been increasing the amount of time dedicated to these activities, then you would be entitled to an even larger credit. Additionally, the state of South Carolina would have a separate \$50,000 credit toward any state income taxes. A multi-year study

If your shop foreman develops and changes a powder coating process and your quality control engineer tests it, you can qualify the time of both employees and the cost of the supplies used.

could save a company hundreds of thousands or millions of dollars depending upon its level of qualified activities.

Why didn't my CPA tell me about this? Due to the technical knowledge needed to understand your business and to determine what qualifies and what does not, your CPA probably never brought it up or simply told you that you didn't qualify. Even if your CPA suggested you might benefit from the credit, most CPA firms don't have the manufacturing background to accurately qualify you.

So how do I get it? Professionals specializing in these kinds of tax credits can weave a net of strength justifying your ability to take this tax credit. The IRS' chosen phrase of "research or experimental expenditures" is subject to extensive interpretation but requires adequate justification. The quality of the supporting evidence can mean the difference between getting the most out of the R&D tax credit and getting denied in the event of an audit. Quality companies will offer you a no-cost, no-commitment solution to see what you qualify for and will include audit defense at no additional charge. ■

Jenny Toole is the marketing director of Paradigm Partners, a national tax consulting firm specializing in niche tax services.

JENNY TOOLE, Marketing Director, Paradigm Partners, JToole@ParadigmLP.com or 281-558-7100 x 117.